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Disaster Assistance and Federal Subsidies for Municipal Bonds

The destruction caused by Hurricanes Harvey, Irma, and Maria to the Gulf Coast and Southeast regions has prompted a discussion of possible ways for federal, state, and local governments to provide assistance to distressed homeowners and businesses. Past discussions have included proposals that would alter the federal subsidies for *bonds* (debt instruments with a maturity date of more than one year) issued by municipal (state and local) governments. This In Focus describes the current federal subsidies available for municipal bonds, summarizes previous changes to those programs that provided for disaster assistance, and briefly touches on selected policy issues.

Current Law

Three types of municipal bonds receive federal support under current law: (1) tax-exempt bonds; (2) tax credit bonds (TCBs); and (3) qualified private activity bonds (qualified PABs). **Table 1** provides the estimated federal expenditures for each program from FY2016-FY2020.

Table 1. Estimated Tax Expenditures for Federal Bond Subsidies, FY2016-FY2020

(In billions of dollars)

Subsidy	Expenditure
Tax-Exempt Bonds	194.7
Tax Credit Bonds	25.8
Qualified PABs	60.8

Source: Joint Committee on Taxation (JCT), Estimates of Federal Tax Expenditures for Fiscal Years 2016-2020, December 2016.

Tax-Exempt Bonds

Bonds are considered to be for a public purpose (or tax-exempt) if they satisfy either of two criteria: (1) less than 10% of the proceeds are used directly or indirectly by a nongovernmental entity; or (2) less than 10% of the bond proceeds are secured by property used in a trade or business. The federal government subsidizes tax-exempt bonds by excluding their interest income from federal income taxation. This lowers debt costs of state and local government by allowing them to borrow at interest rates that are lower than they would be if the interest income were taxable. Municipal governments can issue tax-exempt bonds without federal restriction.

Tax Credit Bonds (TCBs)

Tax credit bonds (TCBs) are an alternative to tax-exempt bonds that provide a tax credit or direct payment proportional to the bond's face value in lieu of the tax exemption. The value of the TCB benefit (and subsequent federal cost) does not depend on the investor's marginal income tax rate. All of the TCBs currently in circulation were established as temporary tax provisions. The relative appeal of TCBs and tax-exempt bonds to investors varies with bond interest rates, marginal tax rate and tax status of the investor, and underlying economic conditions.

Qualified Private Activity Bonds (Qualified PABs)

Bonds that fail both public purpose tests are termed private-activity bonds (PABs) and are generally ineligible for tax-exempt financing. However, there are some activities which fail each test but which Congress considers to provide substantial public benefits, such as water treatment facilities and airports. These activities may be allowed to be financed with qualified PABs, which are tax-exempt. Some qualified PABs are subjected to an annual, state-specific issuance cap, which was the greater of $100 per resident or $305.3 million in 2017. Qualified PABs issued for several activities classified as private are not subject to this cap, including bonds issued for government-owned facilities.

Past Changes to Municipal Bond Subsidies for Disaster Assistance

Federal policymakers have not elected to modify the statutes governing tax-exempt bonds in response to past disasters, perhaps because any public purpose municipal bond is automatically eligible for the tax exemption. However, the federal government has modified both TCBs and qualified PABs in past disaster assistance efforts, as such bonds may provide relief from budgetary shortfalls stemming from both decreased collections and increased spending needs following natural disasters. For a discussion of disaster relief programs administered across the federal tax code, see CRS In Focus IF10730, *Tax Policy and Disaster Recovery*, by Molly F. Sherlock.

TCBs and Disaster Assistance

Gulf Tax Credit Bonds (GTCBs) were designed to assist state and local governments with the fiscal stress imposed by Hurricane Katrina in August and September 2005. GTCBs were created by the Gulf Opportunity Zone Act (GOZA; P.L. 109-135) in December 2005, and provided for issuances in all of calendar year 2006. Up to $350 million in issuance authority was allocated across states, with up to $200 million available to be issued by the state of Louisiana, up to $100 million available to be issued by the state of Mississippi, and up to $50 million available to be issued by the state of Alabama.

GTCBs were largely designed to help with fiscal responsibilities that pre-dated the arrival of Hurricane Katrina, as 95% of GTCB proceeds were required to be used to make bond payments (other than private activity bonds) that were outstanding before Hurricane Katrina made landfall. The maturity length of GTCBs was much shorter than that of many other TCBs, with a maximum allowable term of two years. GTCB credits were eligible to be claimed against regular income tax liability and alternative minimum tax liability.

Midwest Disaster Bonds (MWDBs) were designated for areas impacted by the severe storms that occurred between May and August 2008. MWDBs were created by the Emergency Economic Stabilization Act (EESA; P.L. 110-343) in October 2008, which provided for up to $450 million in MWDB issuances for all of calendar year 2009. States with over 2 million affected residents (Indiana, Iowa, and Wisconsin) were authorized to issue up to $100 million, and those with between 1 and 2 million and (Illinois, Missouri, and Nebraska) could have issued $50 million.

MWDBs proceeds were to be used to pay the principal and interest on any outstanding state bonds or the bonds of any affected political subdivision within the state. The proceeds could also have been loaned to a jurisdiction for the same purpose. The provision required the issuer to issue an equal amount of general obligations for the same purpose, akin to a matching requirement. As with GTCBs, MWDBs had a maximum term of two years.

Qualified PABs and Disaster Assistance

In addition to creating new TCBs, GOZA and EESA each temporarily expanded permissible qualified PAB issuances for municipalities with disaster recovery responsibilities. Both laws temporarily allowed affected states to issue tax-exempt bonds to finance (1) qualified activities involving residential rental projects, nonresidential real property, and public utility property located in the disaster area; and (2) below-market rate mortgages for low- and moderate-income homebuyers. The maximum amount of bonds that each state could issue under GOZA was $2,500 multiplied by that state's population in the affected area prior to the arrival of Hurricane Katrina. Under EESA, the maximum amount of bonds each state could issue was $1,000 multiplied by that state's population in the disaster area, and established need-based prioritization for state allocations.

GOZA and EESA also allowed operators of certain low-income residential rental projects to rely on the representations of displaced individuals regarding their income qualifications so long as the tenancy began within six months of the displacement. Additionally, GOZA provided for one additional advance refunding of qualifying bonds that were issued by affected states. Benefits provided for under EESA were also extended to Texas and Louisiana to assist with recovery following Hurricane Ike.

Table 2 shows 10-year JCT revenue estimates of municipal bond changes included in GOZA and EESA. Subsidies for municipal bonds in those laws were estimated to reduce revenues by a combined $3.8 billion over 10 years.

Table 2. Ten-Year Revenue Estimates of Previous Municipal Bond Changes for Disaster Assistance

(In billions of nominal dollars)

Legislation	TCB Effects	QPAB Effects	Total Effects
GOZA	-0.057	-2.297	-2.354
EESA	-0.152	-1.320	-1.472

Source: JCT, *JCX- 89-05r* and *JCX-78-08*.

Notes: GOZA estimates were for FY2006-FY2015, while EESA estimates were for FY2009-FY2018. EESA estimates do not include revenue effects of bond subsidies for recovery from Hurricane Ike.

Municipal Bonds and Disaster Assistance

The implementation of federal subsidies for municipal bonds may generate considerations specific to disaster assistance policy. A discussion of general municipal bond policy issues may be found in CRS In Focus IF10712, *Key Issues in Tax Reform: Federal Subsidies for Interest Income Generated from Municipal Bonds*.

Both TCBs and qualified PABs can include issuance restrictions across states and localities to ensure that federal benefits associated with the respective program achieve a desired allocation across areas. Examples include restrictions imposed on certain qualified PABs (dependent on population) and on Qualified Zone Academy Bonds (dependent on the population below the poverty level).

There may also be a tradeoff between the timeliness of federally subsidized municipal bond offerings and their effectiveness in targeting the populations most in need of assistance. Allowing for bond issuances relatively shortly after a disaster may provide for more financial relief than bonds with a delay between the disaster and first issuance dates, but may also favor those who are more able to speedily claim benefits, particularly if the bond is subject to monetary issuance restrictions. A 2008 GAO report on disaster assistance in the Gulf Coast region found that:

> For the most part ... eligible states allocated GO Zone tax-exempt private activity bond authority without consistently targeting the allocations to assist recovery in the most damaged areas.

There are budgetary control considerations that may be worth considering. TCBs are issued as either *investor credit TCBs* or *issuer direct payment TCBs*. The implementation of automatic enforcement measures (often described as "sequesters"), as provided for by the Budget Control Act of 2011 (P.L. 112-25), diminishes the credit rates of certain issuer direct payment TCBs through FY2021. For more details on the distinction between investor credit and issuer direct payment TCBs, see CRS Report R40523, *Tax Credit Bonds: Overview and Analysis*.

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