



PERSPECTIVE

Tax Tools for Local Economic Development

BY LASHEA LOFTON

The following is a condensed version of Lofton's address on behalf of GFOA before the U.S. Senate Finance Committee. The hearing was held on July 30, 2024, and Lofton testified about the importance of tax-exempt municipal bonds and how they help ensure that the necessary infrastructure is in place to support economic development.

Our system of federalism requires a strong federal, state, and local partnership to achieve our shared goals. One of the best examples embodying that federal partnership is the tax-exempt municipal bond. I am here to testify that Congress should not only protect this vital tool but consider adopting a number of provisions to further enhance its effectiveness.

I would like to share two key points for your consideration as Congress explores tax tools to help spur economic development:

1. The municipal bonds tax exemption should be fully maintained because it enables state and local governments to invest in the vital infrastructure that supports local community needs.
2. Enacting federal bond modernization provisions will further enhance this financial tool and unlock additional infrastructure investment in urban, suburban, and rural communities.

Municipal bonds are a vital finance tool and the tax exemption should be fully maintained.

Providing communities with strong infrastructure has long been a national priority and a shared goal for state and local governments and nonprofits that heavily rely on tax-exempt bonds to build stronger communities. For more than a century, state and local governments have issued debt to finance capital projects. The construction and preservation of roads, airports, highways, bridges, transportation, affordable housing, water and wastewater, schools, libraries, town halls, nonprofit hospitals and universities, electric power, and gas facilities are just a few examples among a multitude of public projects that rely on tax-exempt municipal bonds. These are the investments in infrastructure that make our communities livable and commerce possible. In fact, the municipal bond tax exemption has played a vital role in our nation's intergovernmental partnership, as no single level of government can adequately provide the necessary funding to address all our infrastructure needs. The tax-exempt bonds issued by state and local governments, and nonprofit entities, have financed more than three quarters of our nation's infrastructure.

The City of Dayton, Ohio, leverages tax-exempt bonds as a crucial strategic resource to continuously improve, expand, and adapt our infrastructure to meet community and economic needs. Our debt funds are often combined with other local, state, or federal resources to maximize their impact, reflecting our commitment to collaboration. Although the city maintains a relatively low debt burden, debt financing has been vital in funding capital projects and equipment purchases that directly benefit our citizens. Since 2018, Dayton has issued nearly \$55 million in tax-exempt bonds, stabilizing neighborhoods, spurring private investment, providing work for contractors and suppliers, and creating jobs, all contributing to the health of our local economy.

In 2022, Dayton financed more than \$21 million in infrastructure, facilities, and outdoor recreation amenities for



Since 2018, the City of Dayton has issued nearly \$55 million in tax-exempt bonds, investing in crucial infrastructure, facilities, public safety and outdoor recreation.

our neighborhoods. Critical street reconstruction and resurfacing projects attracted further investment along our commercial corridors. About \$11 million was dedicated to improving parks and fields, enhancing the city's vibrancy and supporting housing and economic development. We also financed essential public safety equipment such as a fire engine and waste collection trucks. These investments have been catalysts for Dayton's economic growth and vitality.

In 2024, Dayton plans to issue approximately \$23 million in tax-exempt debt for projects including the renovation of the Kettering Fields Softball Complex. This facility, located in a neighborhood primed for redevelopment, supports local youth, adult, and senior softball leagues. Its expansion will meet competition demands and attract further

community and economic development, enhancing neighborhood livability. We also plan to modernize a key parking garage serving the Dayton Convention Center, which is undergoing a \$40 million renovation, and a new hotel in downtown Dayton. This investment is essential to attracting and supporting private investment, driving sustained success for residents, businesses, and visitors.

Such projects and equipment purchases are critical to the implementation of our economic development strategies. As development increases demands on transportation, utilities, schools, parks, and public safety facilities, we must ensure that the necessary infrastructure is in place to support growth.

While the federal tax exemption does reduce the cost of issuing municipal bonds, it is the combination of local

control and local responsibility that makes municipal bonds an effective and efficient tool. Voters throughout the country overwhelmingly support tax-exempt municipal bonds, which are either approved by locally elected officials or directly through bond referenda. And it is residents and businesses in these communities paying the interest and principal on this debt. This important link between citizen and public finance fosters prudent decision making.

Further, our policy is to use debt to finance eligible purposes and projects only if it is the most cost-effective means available and/or meets operational/strategic objectives. The city's primary source of revenue to repay tax-exempt debt is our local property tax. We simply believe that if our community is already paying taxes to allow us to issue debt, we must be prudent in investing those dollars back into the community in ways that benefit them directly.

Millions of Americans depend on municipal bonds as a secure and dependable investment. Nearly 75 percent of individual investors who are bond holders are 55 or older. Businesses also rely on municipal bonds as a safe, stable, long-term investment. Even through a volatile market, the municipal bond has sustained its resiliency and strength, with nearly \$400 billion in new municipal bonds issued in 2023.¹

As a result, over the last decade, overall state and local borrowing is lower in proportion to the economy than it was one decade ago—while still financing more than \$2 trillion

in new infrastructure investments. If allowed to grow and operate unabated, tax-exempt municipal bonds will likely finance another \$3 trillion in new infrastructure investments by 2031.

Because tax-exempt municipal bonds will remain a fiscal bedrock for state and local finances for many years to come, and because they are such a critical investment for millions of Americans, Congress should fully protect the tax exemption of this financial tool.

We especially applaud the efforts of members of Congress for the continued support of tax-exempt municipal bonds. These efforts include legislative initiatives I will touch on in a moment, as well as others like the establishment of the bipartisan House Municipal Finance Caucus. To be clear, the support for tax-exempt municipal bonds is bipartisan, bi-cameral, and very strong, but we still need additional federal policy support to advance initiatives that would significantly move the infrastructure needle at the state and local level.

Today's hearing is encouraging because it demonstrates a commitment to engaging in important conversations on the best ways to strengthen the partnership between the federal, state, and local levels that supports the investment needed by local communities.

Bond modernization provisions would further enhance this tool and unlock additional infrastructure investment.

Without a doubt, municipal bonds have proven to be the preeminent tool for infrastructure investment. But enacting

small enhancements could free up increasingly scarce resources for states and localities while also stimulating investments needed to keep our economy growing. A number of bond provisions that were included in legislation during previous economic crises have demonstrated their effectiveness. As for the immediate need, we respectfully ask that the next legislative package addressing tax and infrastructure finance include the following provisions.

Restore advance refunding of tax-exempt bonds. Restoring the ability of governments and other qualifying entities to advance refund tax-exempt municipal bonds would free up billions of dollars that governments and nonprofits could spend on other projects. State and local governments and nonprofits understand that responding to economic development needs requires strengthening the infrastructure that underpins local communities and institutions. Between 2007 and 2017, there were more than 12,000 tax-exempt advance refundings nationwide, generating more than \$18 billion in savings for tax and ratepayers over the ten-year period.²

We are asking you to restore tax-exempt advance refunding, which would provide immediate debt service savings and near-term debt relief for taxpayers, which can be put to public works and safety purposes. This would be of immense help for planning and budgeting purposes for state and local communities and nonprofits.

In 2018, after tax-exempt advance refunding was no longer available to issuers, Dayton issued approximately \$11 million in debt to finance capital improvements. If tax-exempt advance refunding had still been available to us, we could have taken advantage of favorable interest rates at some point over the life of those bonds and potentially generate a minimum of over \$300,000 in savings for that amount of debt issued.³ This may not seem like much to some cities, but for ours—with a population of nearly 136,000—it would allow us to reconstruct a dangerously deteriorated road in a commercial district, or construct sidewalks and bike

SHARE YOUR STORY

Was your community #BuiltByBonds? Consider providing a few bits of information about a recent project in your community that was financed with municipal bonds.

Enter your information at gfoa.org/built-by-bonds-entry-form

Read other governments' stories at gfoa.org/muni-stories





If allowed to grow and operate unabated, tax-exempt municipal bonds will likely finance another \$3 trillion in new infrastructure investments by 2031.

paths that allow residents to get to one of our newly built local libraries.

Therefore, we fully support and appreciate initiatives like S. 1453, the *LOCAL Infrastructure Act*, which would restore tax-exempt advance refunding.

Increase access to capital for small

borrowers. For many thousands of small issuers and governmental and nonprofit borrowers, an increased bank-qualified borrowing limit—to \$30 million—that applies at the borrower level would provide access to low-cost capital to thousands of small local governments and nonprofit hospitals and healthcare systems for immediate project needs.

Bank-qualified bonds are particularly useful to smaller governments, historically enabling these jurisdictions to finance infrastructure at lower costs than traditional bond financing. Bank-qualified bond issuers save between 25 and 40 basis points, on average. For example, on a 15-year, \$10 million bank

qualified debt financing, an issuer could expect to save between \$232,000 and \$370,000. Raising the bank-qualified debt limit to \$30 million would save issuers between \$696,000 and \$1.1 million on a \$30 million bank-qualified bond issue. This is a substantial savings for our nation's smaller governments, which can be used to maintain and improve valuable community services and finance other much-needed capital improvement projects.

Currently, there is only the LIFT Act, led by U.S. Representative Terri Sewell of Alabama, that seeks to implement these changes for small borrowers. Therefore, we call on the Senate to introduce and advance companion legislation.

Restore and expand the use of direct-pay bond. While it is not currently permitted, in the past, Congress authorized governments to issue taxable direct-subsidy bonds. These bonds allowed the government/issuing entity to receive a payment

from the federal government for the life of the bond, covering a percentage of the interest costs. Restoring and expanding the use of direct-pay type bonds and ending their subsidy exposure to sequestration would create an investment option globally while funding state and local projects. In the past, sequestration ate into the subsidies for Build America Bonds, creating mid-year budget difficulties for many issuers.

Direct-pay bonds would be an *excellent complement* to traditional tax-exempt municipal bonds, but they would be a *poor replacement* for traditional tax-exempt bonds. Together with GFOA members across the country, I want to make it clear that GFOA's endorsement of restoring and expanding the use of direct-pay bond should in no way be construed as an endorsement of using them as a replacement for traditional tax-exempt bonds.

Thank you for your consideration of these important initiatives and for holding this hearing today. GFOA will continue to support your efforts and appreciate your attention as you begin this important conversation on the vital tools that would provide substantial support to local governments in their efforts to build the infrastructure our country so desperately needs. We look forward to working with you and supporting your efforts on this and other regulatory and financial matters of mutual interest. 🇺🇸

¹ John Bagley and Marcelo Vieira, 2023 Municipal Market Year in Review, Municipal Securities Rulemaking Board, January 2024.

² GFOA analysis of Thomson-Reuters data.

³ GFOA's previous best practice on advance refunding recommended a minimum net present value savings threshold of a fixed percentage of the par amount of the refunded bonds (for example, three to five percent) be met before any refunding transaction is considered.



LaShea Lofton is the deputy city manager for the City of Dayton, Ohio.