



PROTECT TAX-EXEMPT BOND FINANCING

Issue: As federal policymakers look for ways to close the budget gap, some have proposed eliminating or limiting tax-exempt interest for all newly issued municipal bonds (securities).

Request: We urge Congress to protect tax-exempt bond financing, which contributes to the financial health of many colleges and universities. Revenue from operations or from restricted gifts usually does not provide enough funds to build, expand, and renovate the plant, property, and equipment needs of a campus, and taxable debt is more costly.

Background: One of the many ways in which the federal government invests in human capital and innovation in the United States is by granting tax-exempt status to colleges and universities whose education and research missions contribute to wide-ranging societal benefits. Public universities are typically run by state governments, while private, or independent, institutions are nonprofit 501(c)(3) tax-exempt organizations. Tax-exempt bond financing available to state and local governments is also referred to as *municipal* or *publicly sold debt*; it is available to independent institutions as *qualified private-activity bonds*.

What is a bond? A bond is a loan instrument enabling an institution to borrow funds from investors to be repaid over a defined period of time. At colleges and universities the life of a bond is typically 30 years and bonds are primarily used to acquire, construct, and/or expand capital infrastructure such as academic buildings, residence halls, student centers, athletic facilities, energy plants, and hospitals. In 2009, higher education bond sales totaled \$22.4 billion.¹

What are the benefits of bond financing? For the purchasers of municipal bonds, the interest earned is exempt from regular federal income tax and, in many cases, state tax as well, and is thereby subsidized by the federal government. Typically, for the institutional borrowers, the interest rate on municipal bonds is lower than on taxable bonds. Tax-exempt bonds are usually offered to a broader investment base than private debt, thus driving down interest rates and creating beneficial terms. The lower interest rates create significant savings by lowering the cost of multi-million dollar construction projects. In fact, NACUBO estimates that at current rates, savings over 30 years are approximately \$415,000 per \$1 million borrowed.

Why do colleges and universities choose bonds as a financial strategy? Not all institutions borrow to finance capital investments. For those that do, many factors are taken into consideration:

- Does the institution's credit rating enable it to borrow at reasonable rates?
- Does the institution have investments that can easily be liquidated or have cash from other sources?
- Can the institution afford to deplete cash reserves or lower unrestricted reserves and maintain adequate operating revenue?
- How will depleting reserves impact measures indicating financial viability? For instance, inadequate unrestricted reserves negatively impacts ratios used to assess financial viability by the Department of Education and could lead to increased federal scrutiny and other consequences.

¹ The Bond Buyer, "2011 in Statistics"

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Example: *The Physical Sciences Complex at the University of Maryland College Park*

The Physical Sciences Complex at the University of Maryland College Park, currently under construction, is just one of hundreds of examples of a higher education facility supported by municipal bonds. The complex is expected to be one of the nation's finest university research facilities in the physical sciences and will support major collaborative efforts with nearby federal agencies, including the National Institute of Standards and Technology, NASA Goddard Space Flight Center, and the National Institutes of Health.

This 158,068 square-foot state-of-the-art research facility, due to be completed in 2013, will house laboratories and research facilities. The State of Maryland has committed to fund—through tax-exempt bonds—the initial part of the complex and the University will also raise capital from private sources to complete the facility. The total project cost is estimated to be more than \$126 million.

The Maryland Capital Debt Affordability Committee judges debt manageability and generally follows the same guidelines as Standard and Poor's to rate a public institution's debt including such factors as: (1) the credit rating of the state; (2) the state's general financial support for higher education as a whole; (3) the state's financial support for the particular institution; (4) the institution's demand and financial factors.

The modern research facilities at the Physical Sciences Complex will enable the university to attract high caliber researchers and promote growth in sponsored research. Some research results may be developed quickly into innovative products and solutions while other projects might be decades from public or commercial use. Hand-in-hand with the discovery of new knowledge, university researchers and their activities also educate students who will become the next generation's scientists, engineers, teachers, and leaders in government and industry.

Example: *Life Sciences Building, Loyola University*

The Illinois Finance Authority (IFA) recently issued a \$58.8 million bond to build a new life sciences building at Loyola University in Chicago. This type of bond financing for not-for-profits (primarily hospitals and higher education) is a proven tool for providing vital public services and creating jobs with a decades-long record of success. Bond issuance for private universities is typically overseen by a unit of state or local government or a municipal bond conduit authority like the IFA, which is authorized by the state legislature to issue bonded debt.

Since the IFA was created in 2004, 496 capital projects have been completed with over \$25 billion in financing. These projects created an estimated 18,000 permanent jobs and over 50,000 construction jobs. Illinois prevailing wage is paid to construction workers on all projects financed through the IFA. Even during challenging economic circumstances, IFA financed 85 projects with a value of over \$2.5 billion during FY11. These projects created nearly 5,000 permanent jobs and nearly 5,000 construction jobs.

Tax-exempt bond financing is a vital financial management tool and should be preserved.

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