STRENGTHENING PUBLIC PRIVATE PARTNERSHIPS

The National Development Council (NDC) has developed a public-private partnership model that combines the efficiency and experience of private construction and management with the lowest cost of capital available - the tax exempt financing that is available in the Muni-Bond Marketplace. NDC’s model requires NO changes in federal tax law. It can be used within existing federal tax law. NDC’s model requires no new appropriations or legislative changes that will generate a significant “score” from the Joint Committee on Taxation.

Basically, NDC’s model protects a local government’s ability to finance new infrastructure in a manner tailored to the needs of that particular community in a true public/private partnership. The model also works well if the local government wants to privatize existing infrastructure, especially if that infrastructure needs to be repaired or expanded.

Here is how NDC’s model works: NDC organizes and controls a single purpose, bankruptcy remote subordinate corporation, which is a Section 501(c)(3) corporation under NDC’s group exemption. That non-profit affiliate enters into an arm’s length contract with the best available unrelated builder to construct, repair or expand the infrastructure. It also negotiates an arm’s length management contract with a best-in-class, unrelated private operator to provide for the efficient private operation.

NDC’s non-profit affiliate will build, repair, expand and operate the infrastructure under a contract, usually a long term lease, with the local government. The terms of that contract are designed to lessen the local government’s burdens by freeing it from the construction and operating responsibilities for the infrastructure. At the same time, the contract will allow the local government to have continuing influence over design, development, operation and maintenance of the facility or infrastructure. That influence may extend to input into rate setting and local concerns such as minority, women or local small business contracting goals. The contract will also insure that the governmental entity shares in any cash flow in excess of that required by its operations and for the eventual return of the facilities when the lease terminates.

As a Section 501(c)(3) corporation, Section 145 of the Internal Revenue Code currently permits NDC’s nonprofit affiliate to finance the acquisition, repair or improvement of the infrastructure with tax-exempt bonds. That permission enables the affiliate top access the tax-exempt bond market – the lowest cost and most efficient source of financing available today. Usually these bonds are issued by a local development authority but the NDC affiliate may itself issue the tax-exempt financing. Rev. Proc. 63-26 permits the NDC affiliate to issue “63-20” bonds if the local government prefers that type of financing and approves the issuance of the bonds. The attached document outlines how the NDC public/private partnership (P3) model works.
As the debate about tax reform and infrastructure investment intensifies, we offer a few recommendations for improvements in the regulatory framework if the local government prefers to finance the improvements with 63-20 bonds. The proposed changes will make the use of 63-20 bonds, the most prevalent means to deliver public/private partnership in the country and the largest vehicle to deliver infrastructure in public/private partnership, much more efficient. This type of financing is the highest volume of all P3 activity except student housing. For example, Toll Roads – including the Indiana toll road ($5B) – use this procedure. NDC itself built $2B in social infrastructure using this tool.

These proposed changes can be implemented administratively without a change in federal law. These fairly simple and straightforward changes will strengthen the ability of NDC’s P3 to lessen the burdens of government. Our experience in the use of tax-exempt 63-20 bonds in these public/private partnerships involving a Sec. 501(c)(3) entity, flags a number of unnecessary restrictions in Rev Proc. 82-26.

First, Sec. 3.05 requires that all of the proceeds of the 63-20 bonds must be used to provide tangible real or tangible personal property. It is not clear that the purchase of a long term lease is the purchase of such tangible property. While a lease of longer than, say, 30 years is usually treated the purchase of the underlying assets under general tax principals, when tax-exempt bonds are issued, bond counsel must give an unqualified opinion which may be difficult to give when the Rev. Proc. 82-26 is so specific that the acquisition must be of tangible property.

Second, that same section prohibits the use of any bond proceeds for working capital. While that makes sense in the context of assuring that whatever is purchased will eventually devolve on the government on whose behalf the 63-20 is acting, amount of working capital, say, 5% would make privatization easier to accomplish. Under Rev. Proc. 82-26, the governmental entity or the for-profit operator must provide the Sec. 501(c)(3) entity with its working capital. This is unnecessary since all of the facilities will eventually devolve into the sponsoring government, including any then-working capital.

Third, Sections 3.01 and 3.05 in many places make it clear that 63-20 bonds can be issued on behalf of only one governmental entity. But it is not clear whether a joint authority created by intergovernmental cooperation is a governmental entity, or whether such an entity is merely acting for the three governmental entities that created it. An entity created under an intergovernmental cooperation agreement may not rise to the level of a governmental entity for this purpose and state laws will vary. In the Background discussion of Section 2, in Rev. Proc. 82-26’s introduction, it is expressly stated that the question of whether an entity is a political subdivision of a state is not addressed. Rather than evading the question, Rev. Proc. 82-26 should have a provision that permits the Sec. 501(c)(3) entity and an appropriate government to agree to designate that it is the governmental entity to approve the issuance of the bonds and to which the facilities will eventually be returned.

Fourth, Subsection 5 of Section 3.05 provides that bonds issued for later improvements cannot mature later than the latest maturity of the original 63-20 bonds. In the context of infrastructure such as a water and sewer system, this restriction is harmful. Bonds for improvements normally are structured to match the maturities of at least a large portion of the useful life of the improvements. Under this provision of the Rev. Proc., in year 35 of a 40 year 63-20 bond issue, an installation of long lived sewer pipes would have to be bond-financed with 5 year bonds – a cost prohibitive increase to the ratepayers would be necessary. Further, under subsection 5 of Section 3.05, the facility would have to be returned to the governmental entity in year 40, free and clear of any obligations when the last of the original 63-20 bonds are retired. This restriction would cripple the operation of the system. We suggest that the designated government should be permitted to enter into an agreement with the Sec. 501(c)(3) entity extending the maturity date to longer term of the lease and/or providing that the governmental entity could agree it would assume any remaining debt that it has approved.

These administrative changes would improve the programs ability to serve the government’s need to provide infrastructure at the most efficient cost.