Financial Services Management

Infrastructure Financial Authority

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Building and Renewing Infrastructure for Development and Growth in Employment Act or the "BRIDGE Act"

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Impact Assessment

- IFA could replace muni bonds or wholly-private capital for high-cost projects if its capacity is sufficient to meet market need and pricing is advantageous to privately-insured municipal obligations or other sources (as seems likely).

- IFA would be largely self-regulating, meaning that it could take on a large role and perhaps pose taxpayer risk despite numerous controls in the bill. IFA has no capital or similar buffer. Instead, its safety-and-soundness decisions would rely in part on ratings, a departure from prior Congressional efforts to limit governmental dependence on the credit rating agencies.

Overview

A bipartisan group of senators has renewed the debate over boosting U.S. financing for infrastructure, proposing a new government corporation – the Infrastructure Financing Authority (IFA) – that would provide loans, loan guarantees, and perhaps other forms of credit enhancement to eligible projects. These would generally be large infrastructure construction and maintenance endeavors in areas like transportation, energy transmission, and

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water quality. IFA is structured as a self-sustaining agency so that, should its procedures prove correct, it poses no taxpayer risk and creates a significant revenue source from which to fund urgently-needed projects. However, aspects of its structure – e.g., the lack of a capital base or prudential regulator – may pose concern despite the use of the government-corporation structure that insulates IFA from direct access to the Treasury should its credit risk undermine its capacity to honor loan guarantees and any other credit enhancements it offers.

Impact

This measure follows years of debate over the best way to increase the role of private capital in supporting infrastructure like bridges, roads, and public-service projects that typically rely on direct issuance by state and local authorities. The Obama Administration has to date supported a federal "bank" that would take this on,[1] but strong GOP opposition to an entity some characterize as akin to Fannie Mae and Freddie Mac has so far prevented action on the concept. This new approach – the government corporation – is designed to overcome this opposition, and its bipartisan sponsorship suggests that this may well have been achieved at least to some extent.

However, questions germane to the GSE debate remain. Like the GSEs, IFA would guarantee certain obligations, and its risk position might be increased vis-a-vis Fannie and Freddie because it could also make direct loans and offer other types of credit enhancement (e.g., credit default swaps, structured credit-risk products, and other financial instruments if approved by the IFA board of directors. None of these obligations carries the full faith and credit of the U.S. Government under the terms of the bill, but the market will likely view them as comparable to "agency" paper – that is, implicitly guaranteed – since IFA's inability to pay claims would raise doubt about the U.S.'s creditworthiness that could extend to many other guarantee programs with adverse taxpayer consequences. Some agencies – e.g., the Federal Housing Administration – are required to hold capital backstops to protect against Treasury draws (expressly authorized for them in contrast to IFA). Nothing like that is proposed for IFA, perhaps out of fear that it would cost too much and delay the authority's ability to meet the ambitious goals set for it. Instead, IFA is structured as an on-budget agency subject to budgetary treatment under the Federal Credit Reform Act (which requires appropriations to ensure that likely costs are anticipated to bolster IFA against unanticipated risk that could adversely affect claims-paying capacity). Credit-support pricing is also to offset the cost of this federal subsidy, although the flexibility allowed to do so (see below) may create risk uncertainty despite resulting public-policy benefits.

[1] See Client Reports in the **INFRASTRUCTURE** series.

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Infrastructure finance has historically relied on bond issuance by state and local authorities to meet general obligations and to fund specific projects (e.g., sewer systems). Key to this bond issuance has long been the use of bond insurance to reduce the risk of loss to investors and simplify analysis of issuances from thousands of entities often too small on their own to capture the attention of rating agencies and other analysts. In the 2008 financial crisis, these bond insurers experienced severe losses and were seen at one point even to pose systemic risk.[2] The industry survived the crisis without a new regulatory model, but its capacity to support municipal bonds has been dramatically reduced and, with it, the capacity of states and municipalities to fund infrastructure is seriously constrained.

Privately-funded projects based on toll or similar income have to some degree replaced bonds, but the market's capacity to support these ventures and the public's willingness to pay for them is limited. Further, these funding mechanisms have difficulty handling multi-jurisdictional projects and those so large as to be of national significance (where federal funding has dropped dramatically due to fiscal constraints and the end of earmark appropriations). Estimates in the bill indicate the U.S. may need as much as $225 billion over the next fifty years for new and maintained infrastructure, and the bill's sponsors think this amount could be raised from institutional investors, sovereign wealth funds and other sources if backstop federal support is provided in concert with new loans.

Unless all of the BRIDGE Act's projects are not feasible with private capital, the prospects for a revived municipal-bond industry could darken and the size and number of private infrastructure projects would likely drop. The bill seeks to avert this by mandating consideration of private financial capacity before any IFA support is authorized. An adverse effect on private capital is also dependent on how IFA prices its support, but it seems likely that it would not only act where private capital cannot, but also replace private capital because of the price advantage enjoyed by a government corporation. However, if private capital lacks the capacity to recover from the crisis, infrastructure finance will remain well below needed levels absent action on some sort of federal backstop, with adverse implications for economic development and U.S. competitiveness according to the bill's sponsors. If, however, IFA replaces private capital due principally to pricing advantage, then taxpayer risk could substitute for that which private investors are ready and able to bear.

Interestingly, the bill uses credit rating agencies (CRAs) in a significant way to limit the risk IFA would take and the manner in which it prices for its risk. The Dodd-Frank Act barred reliance on CRAs for purposes of bank regulation,[3] but this measure mandates CRA use in conjunction with the

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[2] See Client Reports in the **MUNI** series.

[3] See **RATINGS37**, *Financial Services Management*, August 10, 2010.

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Office of Management and Budget to determine these subsidy accounts for loan or guarantee pricing. Indeed, any eligible non-rural project would need to obtain a CRA rating of at least investment-grade and IFA's overall portfolio would need to be at least investment-grade after five years (although what would happen if it isn't is not made clear). This may be intended to protect taxpayers, as IFA is subject only to conflict-of-interest and other governance requirements, but not to a prudential regulator or to any capital or similar requirements to protect the taxpayer should its subsidy or risk judgments prove incorrect. This is consistent with current government-corporation practice, but not with recent proposals to replace GSEs with government corporations or other federal backstops (e.g., the Corker-Warner housing reform legislation[4]).

In general, the bill would use IFA to provide direct loans and loan guarantees. As noted, the board or IFA's CEO could also provide other forms of credit enhancement. These are not detailed in the bill nor are the investment-grade ratings described above apparently required if alternative forms of credit enhancement are employed. Thus, pricing and risk related to these products is not made clear.

What's Next

S. 1716 was introduced on November 14 by Sens. Warner (D-VA), Blunt (R-MO), Graham (R-SC), Gillibrand (D-NY), Heller (R-NV), Coons (D-DE), Klobuchar (D-MN), Wicker (R-MS), McCaskill (D-MO), and Kirk (R-IL). It was referred to the Committee on Commerce, Science and Transportation. There is no companion House bill. Hearings later this year are anticipated, but focused legislative action is likely until early 2014.

Analysis

A. IFA Structure and Governance

1. Purpose

IFA is to fund eligible projects that are found to be economically viable, in the public interest, and of regional or national significance.

2. Government Corporation

As noted, this is the charter IFA would assume under the direction of the Treasury Department. IFA would have a seven-member board appointed by the President and confirmed by the Senate, with the bill detailing necessary qualifications and the partisan balance of the directors and the board chair. The President is instructed to take special account of rural interests and diversity in nominating candidates to the IFA board. IFA would also have a

[4] See **GSE126**, *Financial Services Management*, July 8, 2013.

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chief executive officer, nominated by the President and confirmed by the Senate, as well as other senior management as again detailed in the bill. The board and CEO have designated duties, with the board required among other things to ensure a "measurable" public benefit in all selected projects and provide for "reasonable" public input into project selection. The bill details the duties of a chief risk officer, who would be charged with setting standards for project approval, risk monitoring, and other responsibilities. An Office of Technical and Rural Assistance and Special Inspector General (who would also be named by the President and confirmed by the Senate) would also be required.

Importantly, IFA could not override state law with regard to the projects it funds or supports.

3. Limits

During its first two years, total IFA support could not exceed $10 billion, ramping up to $50 billion when IFA is fully operational.

B. IFA Customers

Entities eligible to receive IFA support include:

- individuals and corporations, including trusts;
- partnerships, including public-private ones in which a governmental entity retains control and the private partners put up at least ten percent of the funds or other contributions according to terms specified in the bill;
- state and other governmental entities; and
- revolving funds.

C. Infrastructure

Eligible projects include construction or repair of:

- inter-city passenger or freight rail and related facilities, as well as inter-city bus and other public-transport infrastructure;
- highway facilities;
- airports and air-traffic control systems;
- port or marine tunnels and other infrastructure;
- transmission and distribution pipelines;
- inland waterways;
- intermodal facilities related to the above sectors;
- water-treatment and solid-waste facilities;
- dams and levees; and
- facilities for energy transmission.

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The IFA board could modify the statutory definitions as needed under criteria stipulated in the bill. As a result, infrastructure might be far more broadly defined over time than now contemplated by the bill's sponsors.

D. Credit-Support Terms

Financing would need to meet public-policy criteria and could not refinance any existing project. The bill also details application procedures and other considerations, such as the political and public support of a project that ensures completion, the employment likely to result from the project, environmental benefits, and other considerations. Importantly, the IFA board or CEO would also need to ensure the likelihood that IFA assistance would cause the project to proceed more promptly and with lower financing costs than would be the case without IFA assistance. Consideration is also required of the extent to which IFA support maximizes the level of private investment in eligible infrastructure or supports a public-private partnership, while providing significant public benefit or mobilizing private resources otherwise unavailable to the project.

IFA funds would have to be repayable, in whole or in part, from tolls, user fees, or other dedicated revenue sources derived from users or beneficiaries that also secure the eligible infrastructure project. Liens could secure IFA financing and be subordinated to other project obligations. Project costs would need to be at least $50 million unless the project is rural (where a $10 million threshold would apply). Project loans or guarantees and the amount of senior project obligations if the loan or guarantee does not receive an investment-grade rating (the bill does not make clear if this rating criterion is applicable to the loan or guarantee or, as seems more likely to be its intent, the overall project financing). Support could not exceed 49 percent of cost and direct loans would need to bear interest rates at least equivalent to comparable Treasury securities. A maximum tenor of 35 years is set for loans and loan guarantees and payment terms beginning five years after project completion are also specified.

To determine the amount of federal support for pricing purposes, the IFA's CEO would need to consult with the Office of Management and Budget and ratings agencies providing preliminary ratings for the relevant project. The fee for IFA credit assistance would need to compensate the federal government for the federal credit subsidy so determined and federal budgeting protocols would largely apply to this program for purposes of calculating its cost to the federal government. GAO audits would also be required, along with a study after ten years to determine if IFA is indeed self-sustaining.

E. Budgetary Treatment

Initially, IFA would be granted a $10 billion appropriation. However, because it is to be self-sustaining this might not necessarily be scored as a cost to the deficit.

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