Bank-Qualified Municipal Bonds

“Bank-qualified bonds” were established in the 1986 Tax Reform Act to give small municipal issuers of no more than $10 million in bonds in a year more affordable access to capital by helping them to sell tax-exempt bonds directly to local, community banks. This saves small municipal issuers that provide public infrastructure (such as schools, hospitals and roads) higher marketing and professional services costs normally connected with selling their bonds.

Local banks understand the infrastructure needs of local issuers and are willing to purchase their bonds. The tax-code, however, presents a barrier because typically, if a bank borrows money to purchase tax-exempt debt from a municipal issuer, it cannot deduct the interest it pays to borrow that money. Banks, therefore, have a disincentive to buy tax-exempt debt but for the bank-qualified provision, which permits banks to deduct the interest for these small issues.

In an effort to assist smaller jurisdictions, and recognizing that the original $10 million limit was never indexed for inflation, in 2009, Congress increased the annual dollar limit for bank-qualified bonds from $10 million to $30 million. Congress also made 501(c)(3) organizations such as hospitals and small colleges eligible for the provision. Furthermore, in order to facilitate pooled borrowings (where for efficiency, the borrowings of several different issuers are combined), the limitation was applied at the borrower level (rather than the total size of the aggregate issue). These provisions, however, expired on December 31, 2010; at that time, the annual limit reverted to $10 million and the additional improvements expired.

In 2011, a bipartisan bill to permanently re-instate the $30M annual limit, facilitate pooled borrowings, and index the limit it for inflation was introduced by Sens. Bingaman (D-NM) and Crapo (R-ID) and co-sponsored by Sens. Kerry (D-MA), Cardin (D-MD), Grassley (R-IA) and Snowe (R-ME). (Similar, bipartisan bills were introduced in 2008 and 2010). A companion bill was introduced in the House -- H.R. 5705 by Reps. Reed (R-NY) and Neal (D-MA). BDA urges Members of Congress to reintroduce these bills and increase the bank-qualified bond limit so that small municipalities have adequate access to cost-effective capital to finance community infrastructure projects.

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