



Rebuild and Renew:

The Impact on Revenue in the Building Industry of Build America Bonds

March 31, 2011

Andrew Goldberg, Senior Director of Federal Relations

Cooper Martin, Manager of Federal Research and Policy Development

Summary

Build America Bonds (BABs), first authorized in the 2009 American Recovery and Reinvestment Act (ARRA), financed more \$180 billion in infrastructure projects in 2009 and 2010. Although most of the attention on BABs has focused on their use in financing transportation projects, the AIA estimates that over the last two years BABs were likely to have financed between \$44 and \$50 billion in building construction activity that required architectural services.

At a time when the building design and construction industry continues to face significant challenges in obtaining financing, BABs represent a successful and efficient tool for underwriting projects that improve the built environment and create jobs.

Introduction: What are Build America Bonds?

All bonds are loans between a borrower (the bond issuer) and a lender (the bond buyer). Depending on the type of bond, the federal government will limit the type of projects an issuer can finance to a set of eligible uses.

For nearly a century, municipalities have been allowed to borrow money by issuing tax-exempt bonds. The buyers of these bonds then receive payments for the principal plus interest for the duration of the bond, and the interest that is collected is exempt from federal income taxes. This tax-exempt income makes the bond favorable as an investment for the buyer and allows the municipality to borrow money at a lower interest rate. If the income from interest payments were taxed, then the lender would demand a higher rate to make up this difference.

Therefore, this arrangement is designed to be a subsidy from the federal government, which does not collect the taxes, to the municipalities, which receives reduced borrowing costs.

Recently, two other categories of tax-preferred bonds have been created to complement tax-exempt bonds. The first are tax-credit bonds, which were established in 1997. Whereas a tax-exempt bond provides an exemption on 100

percent of the interest that is collected by the bondholder, a tax-credit bond provides a tax credit against the interest.

According to the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT), “tax-credit bonds have tended to provide a subsidy that is close to 100 percent of interest costs, [but] the amount of the tax credit can be adjusted, depending on the purpose for which the bonds are issued.”¹ Compared to the “all or nothing” nature of tax-exempt bonds, this arrangement allows Congress to “exempt more or less of each dollar of interest income on a bond and tailor the federal subsidy to the public benefit the Congress expects to derive from the project being subsidized.”

The third and final kind of bond is a direct-pay tax credit bond. These were created in 2009 by the American Recovery and Reinvestment Act (ARRA), better known as the stimulus bill. Although Build America Bonds (BABs) were eligible to be either direct pay or tax credit bonds, just before the program ended the Center for American Progress reported that all issuances had been direct pay.²

Rather than issue a tax exemption to the bondholder, the direct-pay BABs allow the federal government to issue a payment to the issuer. With Build America Bonds, this credit was set to 35 percent of the interest. For example, as the CBO and JCT explain, “the issuer of a direct-pay Build America Bond in which the taxable bond has a face value of \$1,000 and a coupon of 6 percent receives a payment of \$21 for each \$60 coupon paid to bondholders (35 percent of \$60). Because the issuer does not pay tax on the payment, its net interest cost is \$39.”³

Build America Bonds were created to stimulate an economy that was experiencing severe constraints on access to credit. Furthermore, issuers were allowed to use the bonds to finance a wide range of capital expenditures which made the bonds both attractive to investors and flexible to issuers. In spite of strong support from local governments and many financial institutions, the eligibility to issue Build America Bonds expired at the end of 2010.

Much attention has been given in Congress to the unexpected cost of Build America Bonds. It is important to note that these costs have risen primarily as a result of the program’s unanticipated success and not, as some have argued, the overly generous federal subsidies. In fact, the CBO has estimated that both tax-credit and direct-pay bonds are more efficient than traditional tax-credit bonds.⁴

¹ “Subsidizing Infrastructure with Tax Preferred Bonds.” A Joint CBO/JCT Study. Oct. 2009 <http://www.cbo.gov/ftpdocs/106xx/doc10667/10-26-TaxPreferredBonds.pdf>

² Eizenga, Jordan. “Why We Need a Permanent Build America Bonds Program.” Center for American Progress. Oct 19, 2010. http://www.americanprogress.org/issues/2010/10/america_bonds.html

³ “Subsidizing Infrastructure with Tax Preferred Bonds”

⁴ “Subsidizing Infrastructure with Tax Preferred Bonds”

Build America Bonds Provided Assistance

According to Securities Industry and Financial Markets Association (SIFMA), “possibly the most important benefit of BABs was that they had opened up the municipal securities market to nontraditional investors, including pension funds, life insurance companies and foreign investors.”

By providing an attractive tax-credit bond to a wide range of investors, the program exceeded most expectations and over \$180 billion in municipal debt was issued through the BABs program in 2009 and 2010 combined. Generally, the program is discussed as an aid to infrastructure finance. Architects tend to be less concerned with or aware of the details of the financial support that is allowing their projects to move forward and it has been difficult to ascertain the effect of BABs on building projects as the program only existed for two years. The program ended at the end of 2010, however, and more information has continued to be collected and disseminated.

Using data obtained from Thompson Reuters and Sifma, the AIA estimates that BABs were likely to have financed between \$44 and \$50 billion in building construction activity that required architectural services.

The AIA takes no position on the fees that architects should charge for their services, and indeed there is a wide variation in such fees. Assuming for purposes of this analysis that design services in today’s market amount to roughly five percent of total costs, this would mean that the program provided between \$2.2 and \$2.5 billion for architects in the last two years.

Much of that money was used to finance construction in K-12 schools and higher education facilities, but it also financed office buildings, multi-family housing, theatres, and government buildings.

To arrive at this conclusion, the AIA determined that the following uses, which total approximately \$44 billion, almost certainly required design services for completion:

• Civic & convention	\$2,328.0	• Nursing homes	\$4.6
• Government buildings	\$1,707.8	• Office buildings	\$11.2
• Higher education	\$18,859.4	• Primary & secondary education	\$21,067.6
• Libraries & museums	\$325.2	• Stadiums & sports complexes	\$67.1
• Multi-family housing	\$23.2	• Theatres	\$10.2

(In millions)

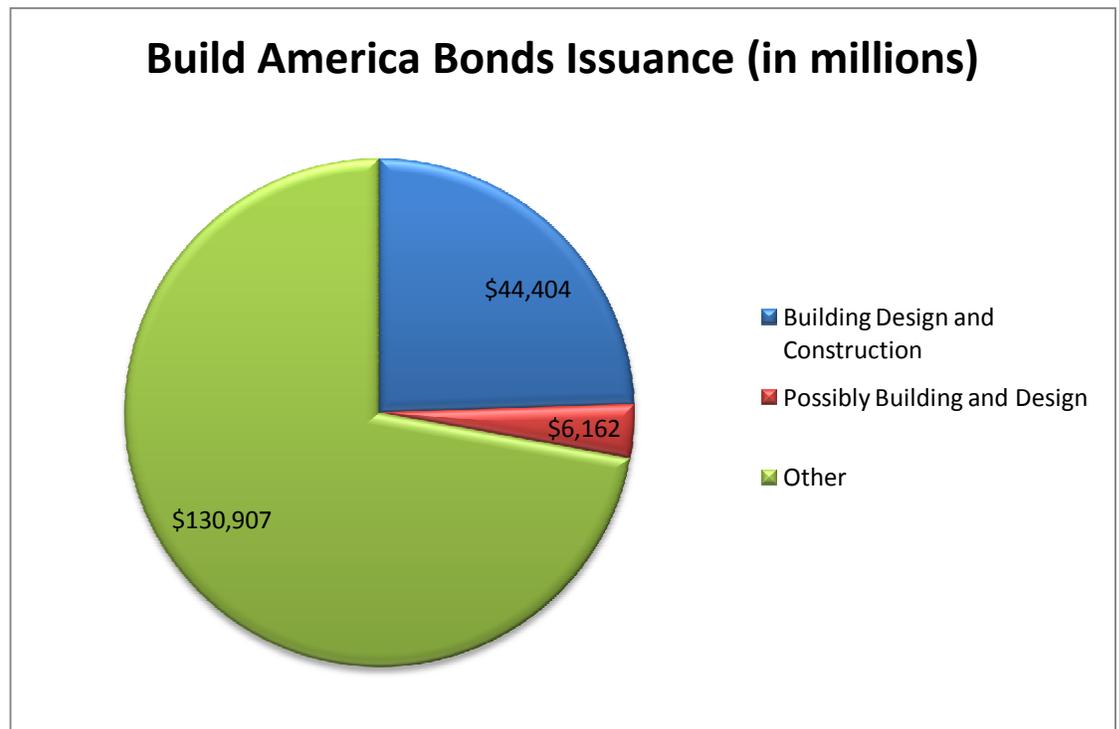
Several more facility types were likely to have included projects that require design services in some of the issuance. These purposes total an additional \$6.1 billion. While not all of these issuances would have been for building construction, a portion of the total likely did.

• Airports	\$2,072.7	• Parking Facilities	\$224.9
• Correctional facilities	\$173.1	• Police stations & equipment	\$47.2
• Fire stations & equipment	\$74.5	• Single family housing	\$25.6
• General acute care hospital	\$3,388.6	• Single specialty hospital	\$23.4

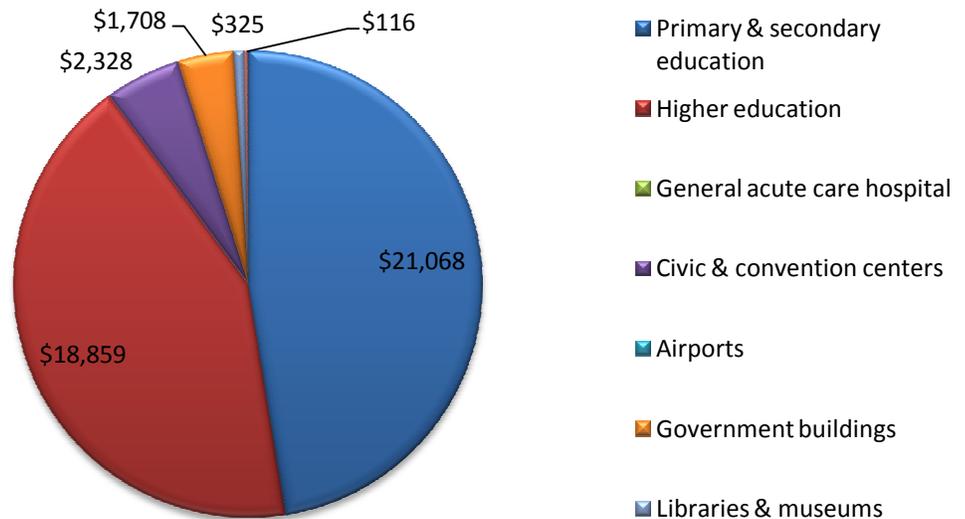
(In millions)

These are estimates in which the AIA can be reasonably confident, but the true value of the program to the building construction sector may have been greater. An additional \$52 billion in BABs issuance was categorized as serving a “general or public purpose.” A further \$14 billion was issued for transportation improvements. Some of this financing may have been used to construct transit stops, bus depots, or other facilities that may have required design services as well.

Much more detailed analysis of the individual bond issuances would be necessary to determine whether this money was used for building construction or for other purposes.



Building Construction Facility Types Financed by Build America Bonds (in millions)



The Need for Build America Bonds Remains Strong

The recession in the general economy has been severe, but it has had a particularly negative impact on the design and construction industry. From 2000-2007, an average of 194,100 employees were engaged in architectural services. Employment today has fallen over 15 percent from that average, and has fallen over 23 percent from its peak in 2007. And the consensus forecast within the industry is that recovery will not occur soon.

Industry Forecasts Show Continued Weakness

The AIA's Architecture Billings Index (ABI) provides an approximately nine to 12 month glimpse into the future of nonresidential construction. AIA research indicates that a construction spending recovery has traditionally followed a design recovery by nine to 12 months. The index is a leading indicator of spending activity within the architectural billings, and architectural billings are a leading indicator for dozens more jobs in construction down-stream.

Recently, the ABI has been more positive, with national scores indicating an increase in design activity this past September and again in November. However, even if these two positive scores indicate a sustainable recovery in design billings, which would indicate that the U.S. is unlikely to see an upturn in construction spending until at least the second half of this year.

The AIA's Consensus Construction Forecast (www.aia.org/practicing/AIAB087264) determined that overall non-residential construction is expected to decline two percent in 2011.

These expectations have been consistent with first quarter activity. "Overall demand for design services seems to be treading water over the last two months," said AIA Chief Economist, Kermit Baker, PhD, Hon. AIA.

AIA members know that this lack of demand is not for lack of worthy projects – it is the result of an inability to access capital. This underscores the fact that there is still a need to ensure that worthy projects have access to capital and that local economies continue to recover.

For more information, contact the AIA Federal Relations Team at 202-626-7438 or govaffs@aia.org.