HOUSING AND INFRASTRUCTURE

The capital markets play a critical role in supporting the development of housing and infrastructure in the U.S. Both housing and infrastructure are critical foundations to promoting economic growth; therefore, it is crucial that the mechanisms for financing these assets are as efficient as possible.

FHFA: AMEND FEDERAL HOME LOAN BANK MEMBERSHIP RULES

The Federal Home Loan Bank System was chartered by Congress, pursuant to the Federal Home Loan Bank Act of 1932, and has a primary mission of providing member financial institutions with financial products and services that assist and enhance the financing of housing and community lending. The Federal Home Loan Bank (FHLB) system helps financial institutions manage their liquidity needs and provides low-cost financing so they can meet the needs of the communities they serve.

Mortgage real estate investment trusts (mREITs) provide liquidity to the real estate markets by investing in residential and commercial mortgages, including mortgage-backed securities. They are an important source of private capital, and it is estimated that mREITs help finance 2.8 million homes in the U.S. These institutions owned and operated captive insurance companies that were members of the FHLB system.

The Federal Housing Finance Agency (FHFA) adopted a final rule that, among other things, prohibits membership eligibility for captive insurance companies and thus for mREITs. These firms must terminate their FHLB membership by February 2021, thus depriving them of the low-cost financing they use to support home ownership.

ACTION: Congress should amend the Federal Home Loan Bank Act of 1932 to clarify mREITs can be members of the FHLB system.

SEC: CLARIFY TREATMENT OF MREITS UNDER THE INVESTMENT COMPANY ACT OF 1940

The SEC should issue a no-action letter to permit partial pool pass-through certificates to be classified as qualifying real estate assets for purposes of Section 3(c)(5)(C) of the Investment Company Act of 1940. This will permit mREITs to continue to purchase securities backed by Fannie Mae and Freddie Mac given whole pools of mortgages are less prevalent under the GSE's Single Security Initiative.

Section 3(c)(5)(C) excludes an issuer from the definition of "investment company" if 1) it does not issue redeemable securities, face amount certifications of the installment type or periodic payment plan certificates; and 2) it is primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interest in real estate.

SEC staff has historically required an issuer to hold 1) at least 55% of its assets in "qualifying real estate assets," and 2) at least 25% of its assets in additional qualifying real estate assets or in "real estate-related assets." SEC staff has classified "whole pool certifications" as qualifying real estate assets and "partial pool certificates" as real estate-related assets. As a result of the Single Security Initiative, Fannie and Freddie have changed the way they create mortgage pools and whole pools of mortgages have become less prevalent, thus making it more difficult for REITs to purchase these securities while maintaining an exclusion from the definition of "investment company" under Section 3(c)(5)(C) of the Investment Company Act.

ACTION: The SEC should issue a no-action letter to permit partial pool pass-through certificates to be classified as qualifying real estate assets for purposes of Section 3(c)(5)(C) of the Investment Company Act of 1940.

IRS: CLARIFY REIT INCOME TEST FOR INFRASTRUCTURE INVESTMENT

REITs could be leveraged to provide more financing for infrastructure in the U.S. However, many infrastructure projects that may easily satisfy the REIT asset tests—such as bridges, parking facilities, airports, rail yards, and ports—do not satisfy the REIT gross income tests if they are owned and operated by the same party. This is because most of their income takes the form of tolls, concession charges, and payments from private parties that do not take the form of a rental or lease income stream.

ACTION: The IRS should amend the REIT income test to encompass infrastructure assets and income derived from the use or operation of infrastructure assets.

NAIC: UPDATE INSURANCE REGULATION TO SUPPORT INFRASTRUCTURE INVESTMENT

The Chamber issued a report in 2018 finding that the insurance industry is a major supporter of infrastructure investment in the U.S. Insurance companies invest in a unique set of assets—such as those that support infrastructure—as a direct result of their business model, which is generally low risk given its predictable stream of future income. The insurance industry has over $6 trillion in total assets and is a major investor in assets that support infrastructure, such as municipal bonds, of which it holds approximately 20% or $800 billion.

In 2019, the Center for Insurance Policy and Research and the Capital Markets Bureau at the National Association of Insurance Commissioners (NAIC) issued a Request for Information aimed at discussing and clarifying topics surrounding infrastructure investments and determining the role of U.S. insurance companies as a source of infrastructure financing.

ACTION: The NAIC should review its risk-based capital framework to identify opportunities for amendments that, without undermining safety and soundness, will promote infrastructure investment by doing more to differentiate between the risk of disparate assets.

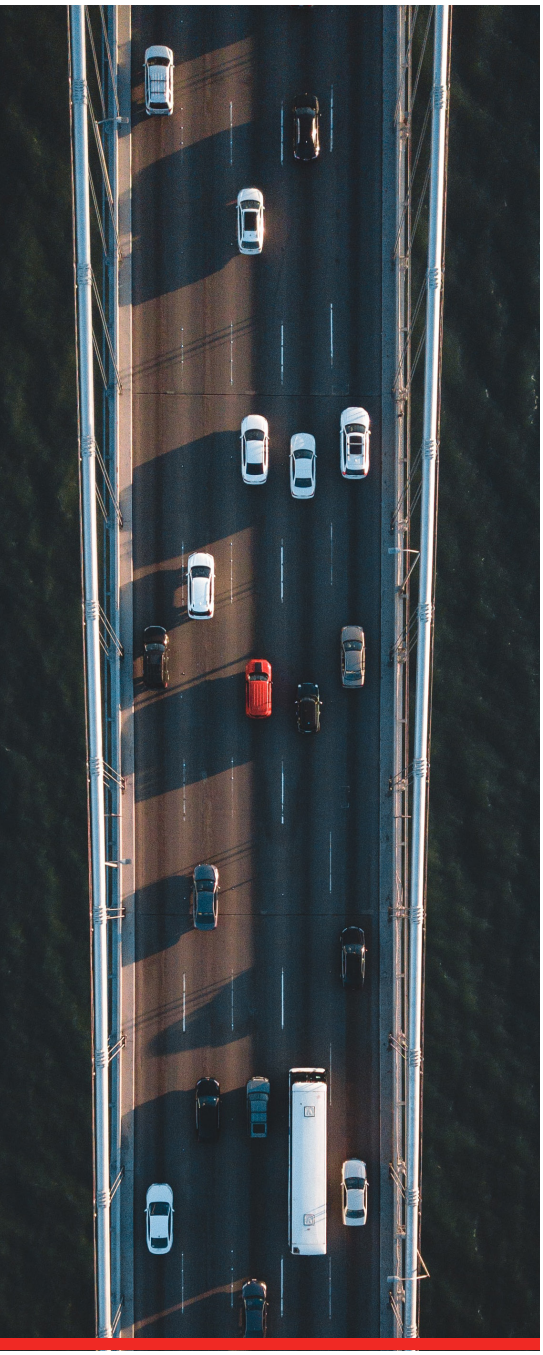
CONGRESS: EXPAND PRIVATE ACTIVITY BONDS

Private activity bonds (PABs) are tax-exempt bonds issued by or on behalf of a state or local government to finance projects that meet certain qualifications. Private activity bonds have an array of qualified uses that permit for the financing of economic infrastructure, like airports, rail yards, roads, and bridges, and social infrastructure, like affordable rental housing, schools, and nonprofit hospitals. They are one of the primary tools used by state and local governments to finance infrastructure projects, and are a critical tool for leveraging support from the private sector via the capital markets.

Investors—which may include individual retail investors or institutional investors like insurance companies —purchase private activity bonds via the capital markets. For example, insurance firms own about 20% of all municipal bonds outstanding, and their annual investments in municipal bonds used for transportation projects could build a road from Washington, D.C., to Los Angeles every year. The tax-exempt status of the bonds makes them attractive to many investors—and the demand for this type of bond helps the issuers, state and local governments, obtain a lower cost of financing than they might receive for a taxable bond.

There have been a number of bipartisan proposals introduced in Congress in recent years to expand the use of PABs. Some proposals have expanded the total amount of PABs that can be issued in a given year by eliminating or extending the current $15 cap on PAB issuances. Other proposals have expanded the qualified uses for PABs to include new types of infrastructure projects.

ACTION: Congress should enact legislation that promotes expanded use of Private Activity Bonds.



CONGRESS: AUTHORIZE DIRECT PAYMENT BOND PROGRAM

A new direct payment bond could allow state and local governments to lower their cost of financing for important infrastructure projects. A direct payment bond provides a subsidy from the federal government directly to the issuers of the bond or to the owners of the bond. This subsidy is efficient and makes the bond more desirable for a broader class of investors (including pension funds), thus lowering the cost of financing for state and local governments. The bonds would also be taxable—which is generally not the case with municipal bonds—thus preserving a source of revenue for the states.

A taxable direct payment bond program (similar to the Build America Bond program) is one of many important tools for state and local governments to finance infrastructure.

ACTION: Congress should enact legislation that authorizes a new taxable direct bond program.