ITCA

INFRASTRUCTURE
Tax Credit Association

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Arizona Infrastructure Tax Credit Proposal

Rebuilding Arizona's Rural Roads…. Enabling Public-Private Partnerships (P3s)

We have spent more than two years listening to Arizonans – rural interests, urban interests, developers, members of the transportation community, government officials at all levels, and interested individuals. There is a clear consensus that Arizona needs more and improved roads, but there is no consensus on how to pay for what Arizona clearly needs.

Economic growth is the life-blood of Arizona, and the life-blood of Arizona's economic growth is transportation – on the border with the new I-11, Nogales/Tucson I-19, in rural sections of the state on I-17 and the Beeline, between Tucson and Phoenix on I-10, and north of Phoenix. Funds committed to building roads and infrastructure are an investment in our economic future, but there is a major shortage of funds for transportation from traditional sources – and that funding shortage is felt the hardest in rural Arizona.

Arizona's rural needs are unique. Most of Arizona's population lives in Maricopa County, but most of Arizona is rural and is in the other 14 counties. Pima and other rural counties are in dire need of help from the state for road and infrastructure repairs and upgrades to maintain and build future generations of commerce. Over half of the nation's winter vegetables either are grown in or pass through Arizona from Mexico via Nogales or San Luis. Texas is beating Arizona in courting Mexico's billion dollar produce companies by outspending Arizona on infrastructure.

A March 2016 Gallup poll showed that 75% of Americans think the federal government should spend more on infrastructure. Yet it's abundantly clear that the demands on government, at both the federal and at the state level, far exceed government's available resources.

Last year's federal five-year highway and surface transportation bill fell far short of what is really needed. There's a shortage of transportation funds, but there is <u>no</u> shortage of transportation needs. John Halikowski, Arizona's Director of Transportation, said in 2015 that "there isn't enough money to solve transportation problems with conventional solutions."

Important groups are beginning to realize that *old solutions* to funding transportation will not generate *new ideas*. Mr. Chris Spear, the newly appointed President of the American Trucking Association, announced on October 5, 2016 that the ATA recognizes the realities of increasing or indexing the federal gas tax – and they will now look for a new infrastructure funding proposal to get behind. Other groups are coming to a similar conclusion.

A New Idea with a 30 Year Record of Success

The Arizona Infrastructure Tax Credit Proposal is based on the federal Low Income Housing Tax Credit, which was created during the Reagan Administration. The federal Low Income Housing Tax Credit has financed more than three million rental homes across the nation since 1986 and is responsible for over 90 percent of the construction for America's affordable housing stock.

The Low Income Housing Tax Credit was created so that private sector funds could help finance America's low income housing assets. Similarly, the Arizona Infrastructure Tax Credit Proposal will create private sector funding for infrastructure by leveraging public infrastructure to attract private capital. It creates new sources for infrastructure funding without acquiring new debt for the state.

Knowledge and Experience

Jim Miller of Total Spectrum devised the Arizona Infrastructure Tax Credit Proposal. He worked in the Administration of President George Herbert Walker Bush – first as a litigator in the Tax Division of the United States Department of Justice, and then as a Senior Official in the Office of Tax Policy in the Department of the Treasury, where he focused on corporate taxation and similar issues -- which included the low income housing tax credit.

The financial modeling for the Arizona Infrastructure Tax Credit was designed by Roman Brilman, Senior Vice President of Meridian Investments – a company that has both designed and then sold over $16 billion of tax advantaged instruments. We asked Roman Brilman to build a financial model that used tax credit certificates that would bring both the maximum sale price per tax dollar for the state and the maximum return on investment for private investors. He achieved both goals.

Key Points of the Arizona Infrastructure Tax Credit Proposal

1. A few pilot projects would be designated as eligible to include private sector funding through the sale of tax credits in the final financing stack. The Arizona Legislature would approve the amount of tax credits to be sold for these pilot projects
2. Developers of the projects in question would apply for the tax credits.
3. Syndicators (a form of investment banker) would bring investors and developers together, and investors would provide equity capital in exchange for tax credits.

4. There would be competition for the tax credits, and investors would bid up the price in a classic free market bidding process. The higher the bid price per tax credit the more private sector capital can go into the financing stack.
5. The percentage of private capital in the final financing stack will depend on the project. A good estimate is that between 20 and 30% of the financing can be private equity raised through the sale of tax credits. The balance will be from bonds, federal and state grants, and various subsidies. The more tax credits are used, the less debt is incurred by the state because tax credits are not public debt.
6. The state, the developer, the syndicator, and investors will all monitor the project to ensure that it meets both the requirements and specifications.
7. Private investors will receive tax credits for five years based on the cost of the construction or rehabilitation of the project. They also will receive a reduction in their applicable taxes from the tax credits – and depreciation for their federal returns.
8. Attracting private sector capital via tax credits will be less costly than attracting capital from tolls and concessions – which often demands a rate of up to 10%.
9. Investors will not look to tolls or concessions as part of their yield. They only want a reduction in their taxes due to the tax credit, and depression.
10. The private sector will be <u>fully</u> accountable. Arizona's taxpayers will not be at risk because the tax credit can only be used when the project is put into service – unlike appropriated dollars that are allocated to a project.

There are financial costs when we build roads.

Funds for building highways come from a number of sources, and are often put together in a financing stack. Public sector funding includes such things as bonding, highway trust funds generated from the gasoline tax, grants, subsidies, and local sales taxes. Some common ways to inject private sector funds include tolls and concessions.

Each revenue source for construction has a financial cost or downside. Bonds – the most common funding vehicle – create more public indebtedness, and the predicted increase in interest rates will mean that bonds will add even more cost to the budget. There is a shortage of available federal funding, tolls and concessions work best in urban rather than rural settings, and Arizona's gasoline tax has not been changed since 1992.

Tax credits do not increase public indebtedness. But they do reduce the state's revenue in the year they are created and allocated.

There are personal and financial costs when we don't build roads.

Costs from congestion, which add on to the time and cost of transportation
Costs from the effects of economic stagnation in rural America.
Costs from the damage to Arizona's Competitive advantage
Costs to rural Arizona commerce when one accident can close the entire freeway

Enabling Public-Private Partnerships (P3s)

The American Enterprise Institute's J. Richard Geddes wrote in AEI's December 26, 2016 edition of Inside Sources that America is *decades* behind other countries in P3 utilization. Mr. Geddes states that part of the reason for this is that there is not an appropriate financial instrument that works with Public Private Partnerships.

> "There is bipartisan agreement that greater private participation in infrastructure through public-private partnerships can improve infrastructure delivery, help ensure on time and on cost project delivery, innovation in project design and construction, incorporate global expertise, and access to new sources of capitol. America is decades behind virtually every other developed country in PPP utilization. One factor is the lack of financial instruments that help reduce cost differentials between government-issued debt and the privately issued debt associated with a PPP."

The Arizona Infrastructure Tax Credit Proposal is uniquely qualified to help fund public - private partnerships. The federal Low Income Housing Tax Credit created a new and unique P3 – investors from the private sector were attracted by a tax credit from the public sector to fund private low income housing, meeting a public goal.

Rural Arizona's Roads need Rebuilding

Arizona's urban infrastructure needs are vital, but areas like Maricopa County have already raised their local taxes for much needed infrastructure. But Arizona's infrastructure needs in rural counties and towns and on the Mexican border are critical.

We know that our proposal can play a significant, long term role in both rebuilding – and lowering the net cost of rebuilding – Arizona's rural roads. The Arizona Infrastructure Tax Credit would reduce the need for more debt, reduce the need for private equity investment (tolls and concessions) that require a 15% rate of return, and would help ensure that projects get completed on time and on budget – because the investors cannot utilize the credits until the road is placed in service.

Economic growth is the life-blood of Arizona, and the life-blood of Arizona's economic growth is transportation. The Arizona Infrastructure Tax Credit Proposal can help rebuild Arizona's rural roads, enable public-private partnerships, and help enhance Arizona's rural and border economy for years to come.