TESTIMONY OF JEFF SEIDEL

Parkway Muni Resources
Investment Banking Consultants
5128 Dupont Avenue South
Minneapolis, MN 55419
phone: (612) 824-8565
fax: (612) 824-3943
e-mail: parkway@real-time.com

BEFORE THE SENATE FINANCE COMMITTEE

HEARING ON SMALL BUSINESS AND RURAL ECONOMIC DEVELOPMENT
June 4, 2002

Mr. Chairman and Members of the Committee, my name is Jeff Seidel and I am the president of Parkway Muni Resources, a firm located in Minneapolis, Minnesota. Our firm specializes in obtaining financing for non-profit, governmental and commercial enterprises, particularly those that do not easily qualify for conventional financing in either the commercial banking or the investment banking markets. Currently, many of my clients are American Indians, who as we all know, often have a difficult time financing non-gaming activities in the conventional markets.

Today, I welcome the opportunity to comment on both the extension of tax incentives for business investment on reservations and the important task of financing the construction and capital improvements of Bureau of Indian Affairs (BIA) School Facilities throughout the nation.

First of all, I want to thank you for your strong support for tax incentives that promote business investment on tribal lands, and specifically for your recent efforts to extend section 168(j) of the Internal Revenue Code. This provision provides for accelerated depreciation of business property located on Indian reservations. It was extended to operate through 2004 as part of the stimulus package that was enacted earlier this year.

<u>Extension of Tax Incentives:</u> As you know, many Indian reservations face extremely high unemployment rates, little or no industrial base and inadequate infrastructure. Tribes are generally unable to attract the investment capital that is necessary to create economic development opportunities and bring stable jobs to the reservation economy. That is why targeted incentives are so important. Property on qualified Indian land and accelerated recovery under section 168(j) has the potential to reverse this trend and

bring investment and jobs to the reservation. For example, accelerated cost recovery has been responsible for bringing a 540 megawatt merchant power plant to the Fort Mojave Tribe in Arizona. In addition, many Western tribes are hoping to use the benefits of this incentive to attract companies interested in energy and natural resource development. These economic development opportunities, however, require a substantial commitment of capital over an extended planning horizon. Many companies are hesitant to invest on tribal lands not knowing whether 168(j) will be renewed after 2004. For this reason, it is critically important that Congress act to extend 168(j) through 2005.

Energy developments are good examples of projects with long term placed-in-service horizons, but many investors rely on this incentive for non-energy projects. Non-residential real estate development and business equipment also benefit from accelerated cost recovery. They are key ingredients to economic development that should not be excluded from the investment incentive.

<u>Tribal School Bonding Bill (S243):</u> Regarding BIA School Facilities, while most public schools are funded through locally generated taxes, based primarily on property values within a particular school district, the same does not hold true for almost all BIA-funded Indian School Districts. For the most part, as many of us know, the responsibility for funding new construction or capital improvements to BIA Schools rests entirely with the federal government.

The GAO has determined that there is a $1.0 billion backlog in BIA School construction and improvements. While there have been bipartisan efforts to increase the appropriations available for construction, the unfortunate reality is that these increases have been insufficient to significantly reduce the backlog.

The Dakota Area Consortium of Treaty Schools and others who have been concerned about this issue believe that leveraging federal funds could help speed up these needed construction projects and reduce the backlog while helping the Tribes develop relationships with financial markets that could help economic development in other areas. We have worked with Senator Tim Johnson, Senator Ben Nighthorse Campbell and other Senators and Congressmen on both sides of the aisle to develop this idea.

The issuance of bonds supported by tax revenues (or moneys derived from taxes) has been used for years in public schools and also for county and state projects. Many Tribes have sought the same solution for Indian projects and schools, only to find tremendous resistance from both the Department of Treasury and from those in the budgeting process. Other financing vehicles, such as contracting with the General Services Administration to lease schools over a period of time, and leveraging those lease payments (as has been done for many federal buildings), or utilizing the capital reimbursement program authorized by PL93-638, as amended, have each met with opposition from both the capital markets and the federal agencies involved. Direct appropriations are, of course, the simplest solution, but appropriations are obviously quite limited given the gargantuan need that continues to grow exponentially. Even in the prosperous times of the 1990's, only two to three schools were funded each year. At

that pace it is doubtful that the federal government will ever reduce the backlog. We have looked at all of the alternatives we could think of, and the culmination of that effort is a proposal to allow Tribes to issue bonds to construct schools, where the principal portion of the bonds is paid through an escrow account established at closing and funded through monies funded in the bill, and the interest is paid in the form of federal tax credits. Also, a bond trustee will be retained to monitor the payments of both the principal on the bonds and the application of tax credits. This will provide ample protection to bondholders, and therefore greatly interest the capital markets in this form of financing. As such, an assignment or pledge of the schools as collateral will be unnecessary.

<u>Specifics for the Extension of Section 168(j) of the Internal Revenue Code</u>

Perhaps the most effective way in which to encourage economic development on tribal lands (and encourage the job and revenue creation that flow from project development) is to accelerate the depreciation rules for property used predominantly within an Indian Reservation (section 168(j) of the Code). While this provision does not expire until the end of 2003, the enormous investment capital and extended planning horizon of energy projects make it imperative that the rule is extended in the near future so that tribes can attract these many projects. In addition, Indian tribes throughout the country have requested that Congress act to extend 168(j) as part of the energy tax legislation recently passed by the Senate Finance Committee.

In 1993, Congress passed legislation that created a variety of incentives for businesses to invest on tribal lands and for tribes to spur economic development. These incentives became effective on January 1, 1994 and will expire on December 31, 2003. One key incentive provided by Congress was the ability of taxpayers doing business on reservations to take accelerated depreciation on "qualified Indian reservation property" and "qualified infrastructure property" (168(j) of the IRC).

Also, as you may know, comprehensive energy legislation passed by the House of Representatives last year included a provision that extended 168(j) for an additional three years (while narrowing the application of the credit to energy related projects). The Senate bill extends the expiration date to the end of 2005 but does not limit the benefits only to energy projects. The Joint Tax Committee estimated the revenue cost of that extension at $175 million over ten years.

In order for a taxpayer to qualify for this accelerated depreciation provision the "qualified Indian reservation property" must satisfy several conditions:

- **The property must be used by the tax payer predominately in the active conduct of a trade or business within an Indian reservation;**
- **The property must not be used or located outside the Indian reservation on a regular basis;**
- **The property must not be acquired directly or indirectly from a person who is related to the taxpayer;**

- **No portion of the property is placed in service for purposes of conducting certain gaming activities; and**

"Qualified infrastructure property" is also eligible, and can include property located outside the Indian reservation. Tribal infrastructure must be available to the general public, and be placed in service in connection with the active conduct of a business within the reservation. This type of property includes roads, power lines, water systems, rail spurs and communications facilities.

Property qualifying under Section 168(j), benefit under the following accelerated depreciation schedule:

Regular Depreciation Schedule	Accelerated Schedule
3 year property	2 years
5 year property	3 years
7 year property	4 years
10 year property	6 years
15 year property	9 years
20 year property	12 years
Nonresidential real property (39 years)	22 years

Again, with an extension of Section 168(j), Tribes may pursue long-range projects with business investors with the knowledge that the tax incentives associated with the project will be available for many years to come. Long term projects with significant levels of capital investment can provide a stable foundation for economic growth in Indian country.

Specifics for the Tribal School Bonding Bill – S243

S243 represents efforts by both the public and private sectors to find at least a partial solution to the backlog for Tribal Schools. The program created by S243 provides tax credits to pay interest on school construction bonds and establishes a cash escrow account to pay the principal on these bonds, which would be issued for the purpose of funding building renovation and new school construction at BIA and grant schools.

In order to receive a bond allocation under S243, a Tribe would submit a plan of construction to the Secretary of the Department of the Interior. The plan would demonstrate that a comprehensive survey has been undertaken of the construction and renovation needs and would describe how the Tribe would ensure that proceeds from the bond issue are used for the purpose intended by the proposal. After reviewing the proposal, the Secretary of the Interior would allocate a designated amount of bonds to the Tribe, and the Tribe would access the public markets for the purpose of raising funds for the project. It should be noted that those projects on the BIA's prioritization list shall be given first priority to qualify, and then other projects can be qualified on a

first-come, first-served basis. (This should not be construed as an endorsement of the current priority list. We believe there are inequities in the current list, but these should be addressed separately.)

Under existing public laws, Tribes may contract with local architects, engineers and construction firms, among others, for the purpose of determining the physical plant needs of the Tribal school and for the design and engineering of such facilities). Under this bill, the Tribe will also have the authority, once the Secretary of the Interior has provided a bond allocation, to contract with a financial advisor, underwriter, attorney, trustee, and any other professional who would be able to assist the Tribe in issuing bonds to the public sector.

Under S243, individual Tribes will be allowed to issue taxable bonds for the purpose of new construction or facility improvement and repair, with the following collateral provided by the bill. As you know, Tribes already have the statutory right to issue both taxable and tax-exempt bonds, but this collateral is for the benefit of the bondholders.

> **The <u>Principal portion</u> of these taxable bonds would be set aside up front in an escrow account. The bill authorizes an annual appropriation of $30 million for this purpose. Once a tribal plan has been approved, the Tribe would be able to issue bonds on an "interest only" basis for a period of 15 years, at which time the entire balance of principal would become due and payable. The funds in the escrow account would be invested in very secure investments (such as SLGS, Treasuries, and Agencies,) that would ensure funds would be available at that time to pay bondholders. It is common practice to have a national accounting firm confirm that the funds would be available.**
>
> **Under current market conditions, $30 million invested for 15 years could grow to about $70 million. Thus, the effect of this bill would be to allow the Secretary to approve up to $70 million in projects in the first year of the project. Leveraging federal funds in this way would help to reduce the backlog more quickly than simply appropriating funds directly without increasing the cost to the federal government.**
>
> **The <u>Interest portion</u> of these taxable bonds will be paid in the form of a "tax-credit" to be provided by the federal government through this bill. This is similar to the credit provided to purchasers of the Qualified Zone Academy Bond program, which Congress recently extended. The total amount of tax-credits provided to new and future bondholders will depend on the amount of bonds issued, and the prevailing market rate on the bonds. For each of the two years covered by S243, the sum of $200 million in bonds would be authorized for issuance. The total cost of these bonds to the federal government is significantly less; the JCT estimated the cost to be $111 million over 10 years.**
>
> **It is not expected that the program, using the principal escrow account as authorized in this proposal, will utilize all of this bonding authority. But there may be alternative uses for this authority among Tribes which may have some cash to pledge to establish separate escrow accounts, with that cash building in value over the 15 years as described above. Thus, some Tribes could take advantage of the interest portion of this program, even if no additional funds are available to pay the principal on the bonds.**

For the bondholders, instead of receiving interest in the form of cash, they will receive a tax credit against their federal income tax liability. If $70 million in bonding allocation is approved, the investors will receive about $75 million in tax credits over 15 years, at current market conditions. And the remaining tax credits may be used for future financing if more money is funded in the escrow account.

The bill also provides detailed definitions of the roles of bond trustees, needed to successfully issue these bonds. The bond trustee would act as a gatekeeper of funds transfers, both from investors to contractors, and from the federal government to the investors (the escrow funds and the tax credits). While not specifically mentioned, the method of transfer of funds is provided through industry standard, and can be written in the bond indenture to avoid timing issues.

Given the rules governing trustees and the statutorily-defined safety of the investments, there is strong certainty that bondholders will be repaid. However, neither the issuing Tribe nor the federal government will have a legal obligation to repay the bond principal, and tribal sovereign immunity will remain intact. Furthermore, neither the education facility(ies) nor the land the itself will be mortgaged or used as collateral for the bonds. In the extremely unlikely event of a default, the bondholders will not have any recourse to the Tribe or its assets.
We do not think any of these arrangements, or the lack of a federal "guarantee," will scare off investors. To the contrary, our experience in this field tells us that the appropriated escrow, with the statutory conditions on its management and use, will attract eager investors from the private markets. The bonds issued under S243 will be seen as good, safe, and sound investments.

<u>Other Benefits:</u> The proposed bonding process would greatly assist Tribal Schools in obtaining timely funds for their projects. This bill will also help connect Tribal communities to investment banking markets. Granted, the source of repayment for these bonds does not come from the Tribes. However, having worked in Indian Country this past decade, I see the hesitancy many investment banking firms have in doing business with Tribes, and also the relative distrust Tribes have for the capital markets. Many abuses have happened. This bonding bill will assist in breaking these barriers down, which is essential if the Tribes are to pursue economic development successfully.

The other benefit for Tribes is that this program would finally allow for the design and construction process for Tribal Schools to proceed locally, using bonded architects, engineers and construction companies. It would permit use of the trust departments of private financial institutions to maintain control over disbursement and re-investment of the funds. It would allow Tribal Schools to raise "seed" money for professional services such as architects and engineers, through the issuance of debt guaranteed by the eventual issuance of these bonds. And it would involve federal oversight but without the tremendous delay in the design, engineering and most importantly, the funding of the projects.

Because local architects will be used, the designs should take into account the local environment and other considerations unique to the area and culture. Also, local

contractors would use Indians and other minorities to help build the school, providing employment and developing job skills. But most importantly, local firms which are familiar with designing and building public facilities would complete the project in an accelerated manner, as compared to the current system, and thus remove the added costs of construction-delay inflation. Under S243, we could give them a budget, provide them with mandatory deadlines for this pilot program, and let them work with the local Tribal School District to complete the project on a timely basis.

Thank you for this opportunity to testify today in support of S243 and the extension of tax incentives that promote business investment on tribal lands. Your interest in this issue sends an important message to Indian country that you care about what happens on our reservations and about the future of Indian children. I would be pleased to respond to any questions you may have.

Points of Interest regarding Tribal Schools:

- **There exists a unique political and legal relationship between the government of the United States and governments of Indian Tribes. Indian Tribes have a legal relationship with the United States government which is set forth in the Constitution of the United States, Treaties, federal statutes and judicial decisions.**
- **The Constitution of the United States gives the Congress plenary (full) powers over Indian affairs, and through treaties, statutes, executive orders, course of dealing and custom, the United States has undertaken a trust obligation to protect Indian Tribes and tribal resources.**
- **The trust responsibility includes the duty to protect, preserve and enhance tribal assets and resources, and to assist Indian Tribes in improving the socio-economic status of Tribes and their members in an effort to encourage economic development and strengthen powers of self-government.**
- **By fostering the development of accommodative financial markets and tribal access to capital, the federal government can assist in providing fundamental tools to greater economic development and powers of self-government.**
- **The need for financial capital by Indian Tribal governments is acute, and the federal government should work to facilitate capital creation and those mechanisms that will permit the tribes, with the assistance of the federal government, to issue debt instruments as a means of financing Tribal government needs.**
- **For the benefit of Indian people across the United States to increase their commerce, welfare and prosperity and the improvement of their health and living conditions, it is essential that this and future generations of youth be given the fullest opportunity to learn and develop their intellectual and mental capacities.**
- **It is essential that institutions of education be provided with appropriate additional means to assist such youth in achieving the required levels of learning and development of their intellectual and mental capacities.**
- **Institutions should be enabled to finance indebtedness to preserve and enhance the facilities for the purposes of education.**
- **There is approximately 16,600,000 square feet of space in Indian schools nationwide.**
- **There exists a backlog in Grant Schools and Bureau of Indian Affairs School facility improvement, repair and new construction needs of $754 million as of March, 1998. It is estimated that the cost of the $754 million in deferred maintenance grows by $22.6 million per year due to inflation , and approximately $33.9 million per year due to natural aging and deterioration, for an annual total of $56.5 million per year in growing needs.**
- **The replacement value for Tribal schools is estimated to be $2.2 billion.**

- **The magnitude of the dollars and number of projects has risen to a level where these projects cannot be funded by current Facility Improvement and Repair and New Construction program funds.**
- **With the physical condition of Grant and Bureau schools deteriorating, and with the population within these schools increasing, there is an immediate need for funding of these projects.**
- **It is the purpose of this bill to provide a measure of assistance and an alternative method of financing to enable the tribal institutions of education to provide the facilities and structures which are sorely needed to accomplish the purposes of this bill.**
- **True self-determination in any society of people is dependent upon an educational process which will ensure the development of qualified people to fulfill meaningful leadership roles. This bill will incorporate the commitment of the federal government to guarantee payments of principal (through a direct appropriation of an escrow fund) and of interest (through the allowance for future tax-credits to investors), so that Tribes with negligible resources may issue bonds to fund school improvements and/or new construction.**
- **This bill will also incorporate the commitment and support of Tribal self-determination by utilizing PL93-638, Section 102 and PL100-297 to allow tribes to manage their own construction projects.**