What a Shift In Power in the Senate Could Mean for Munis.

WASHINGTON – A Democratic takeover of the Senate, as has been predicted by some polls, could mean good news for tax reform as well as maintaining the tax exemption of municipal bonds, according to several muni market participants.

Micah Green, a partner with Steptoe and Johnson in Washington, said that the formula to accomplish tax reform after at least six years of debate would be perfect under three very possible conditions.

"If the Senate turns Democrat, the House stays Republican, and Secretary [Hillary] Clinton wins the presidency, what was the makeup of the House and Senate when The Tax Reform Act of 1986 passed?," he asked, adding, "A Republican president, Republican House and Democratic Senate."

In addition, Sen. Chuck Schumer, D-N.Y., who is in line to become Senate Majority Leader if the Democrats win the Senate, has made tax reform a top priority, as has House Speaker Paul Ryan, R-Wis., who spearheaded the GOP blueprint for tax reform released this year, he said. This bipartisan agreement is necessary for comprehensive tax reform, Green noted.

"The lesson from '86 is, if the White House is committed to some form of tax reform discussion, then I think Chuck Schumer and Paul Ryan would try and get it done," he said. "The pure policy idea of having a serious discussion or action on tax reform is very much in the wheelhouse of both Schumer and Ryan."

As of Wednesday, Democrats had a 59% chance of taking back the Senate in next week's election, according to the New York Times, which bases its data on state and national polls. The House of Representatives is widely expected to remain Republican.

Republicans currently hold 54 Senate seats, while Democrats hold 44 and independents hold two. Of the 34 seats up for election next week, 24 are Republican-held. For Democrats to re-take the Senate, they must win 15 seats. To maintain control, Republicans would need to win 21 seats.

Several muni participants have taken note and have begun to analyze how a shift in the balance of power in Congress could shape their goals for the next administration.

John Godfrey, the senior government relations director for the American Public Power Association, said APPA has been in talks with Republicans regarding their blueprint for tax reform released in June, which proposes repealing unnamed special-interest provisions, leading some muni participants to believe the tax-exempt standing of munis could be in jeopardy.

Godfrey said whichever party controls Congress, their message should be consistent: maintain the muni exemption to keep borrowing costs low for issuers.

"Some Democrats believe munis are inefficient and want to increase inefficiency by changing them," Godfrey said. "We think they're wrong."

“Some Republicans think munis over-encourage spending,” he added. “We also think they’re wrong.”

Still, Godfrey said there are plenty of members from both parties of Congress who understand the importance of municipal bonds as an efficient financing tool and that he is “heartened” by the Democratic platform, which supports the exclusion of interest for tax-exempt munis.

“I think that was significant,” Godfrey said. “One of the problems has been that for a long time there’s been an assumption that the tax exemption of munis was a given and there was not a whole lot of advocacy in support. Suddenly that’s not a given.”

Godfrey cited several proposals to tax or place a surtax on munis that have surfaced in recent years, including those in President Obama’s budget requests that would cap the value of the muni exemption at 28%.

Clinton has proposed a 28% limit on the tax benefit from specified deductions and exclusions, but has not said if that will include the muni tax exemption.

Proponents like Godfrey stress the low costs the muni exemption provides for issuers in financing infrastructure costs, while opponents contend it is an inefficient method of borrowing that leads to federal revenue losses.

Emily Brock, director of the Government Finance Officers Association’s federal liaison center, said she could not comment on what a party change would mean for munis.

“There are many legislators from both sides of the aisle who have offered unwavering support of the muni and recognize its importance as the primary financing tools across the U.S. to satisfy infrastructure needs,” she said.

Sen. Orrin Hatch, R-Utah, is the current chairman of the Senate Finance Committee. He would likely be replaced by Sen. Ron Wyden, D-Ore., the ranking minority member, if Democrats seize control of the Senate,

Wyden, who has previously expressed support for municipal bonds, would be welcomed as the finance committee head, said Justin Underwood, federal policy advisor for Bond Dealers of America.

Underwood said that although Wyden does not have an extensive legislative record on munis, Oregon’s has had $26 billion of infrastructure construction and improvements financed through munis over the past decade.

“We know that he is following the issue very closely, both in terms of how the pieces of the puzzle fit in tax reform discussions and, possibly, into negotiations on an infrastructure plan,” Underwood said. “We hope that Sen. Wyden will continue to place the benefits of municipal bonds and preserving their full tax-exempt status at the top of his priority list.”

BDA will be tracking any legislation effecting municipal finance and attempts to limit the tax exemption of munis, including bills in both the House and Senate that would treat certain munis as high quality liquid assets under bank rules and raise the limit for bank-qualified bonds. Pending before the Senate Finance Committee is The Municipal Bond Market Support Act of 2016 (S. 3257), which would raise the annual issuer limit for issuers of bank-qualified bonds to $30 million from $10 million and index it for inflation.

The bill was introduced in July by Sen. Bob Menendez, D-N.J., as an identical companion bill to The Municipal Bond Market Support Act of 2015 (H.R. 2229) introduced in the House in May of last year by Rep. Tom Reed, R-N.Y.

Brock said that when Congress' temporary increase to a $30 million issuer limit in 2009 and 2010 provided state and local governments with significant benefits. GFOA is now asking Congress to permanently increase the limit.

"We remain hopeful that this issue will be addressed this year and remain committed to work with Senators Menendez and Cardin to make this happen," Brock said. "If it isn't completed this year, it will remain a priority for GFOA in 2017."

The House passed a bill (H. R. 2209), and a similar one is pending in the Senate (H.R. 3404), that would require federal banking agencies to treat as high quality liquid assets (Level 2A) any muni obligations that are liquid, readily marketable and investment grade as of a certain date.

Another bill pending before the Senate Finance Committee is The Green Bank Act of 2016 (S. 3382), which was introduced by Connecticut Democrats Sens. Chris Murphy and Richard Blumenthal as well as Sen. Sheldon Whitehouse, D-R.I., in September.

The bill would create a federal green bank to attract larger private investments in clean energy and energy efficient projects. An identical companion bill was also introduced in the House.

The Bond Buyer

By Evan Fallor

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