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GOP Tax Plan Puts Billions in Muni Market Savings at Risk.

State and local stakeholders were blindsided by an aspect of the tax bill that would eliminate tax-free financing for many large government projects.

In a surprise move, the Republican tax plan released on Thursday contains a proposal that finance experts say would be devastating for governments trying to find money for economic development projects.

The bill would eliminate all private activity bonds, which allow tax-exempt municipal bonds to be issued on behalf of a government for a project built and paid for by a private developer. Tax-exempt bonds fetch lower interest rates in the municipal market and therefore lower the overall cost of financing. The projects financed with this type of debt are typically things in the public interest, such as low-income housing, hospitals or airports.

Nixed State, Local Tax Deduction Makes New GOP Tax Plan a Tough Sell for Some Republicans
“It’s been a big surprise to the entire public finance community,” says Will Milford, a tax attorney at the firm Bryant Miller Olive. “For months, we’ve been hearing that munis were safe.”

Milford added that targeting private activity bonds is especially confusing because those types of bonds are the “logical way” to stimulate private investment in infrastructure — a hallmark of President Trump’s campaign. In fact, during his confirmation hearing, Treasury Secretary Steve Mnuchin suggested that private activity bonds could be expanded.

“It goes against everything we were hearing would be a focus,” Milford says.

The federal government, though, would benefit from eliminating private activity bonds because it currently loses out on collecting tax revenue from the interest they earn for investors.

Many state and local government stakeholders are warning of dire consequences.

Oregon Treasurer Tobias Read said in a statement that the proposal would functionally eliminate the Oregon Facilities Authority. Over the past 27 years, $9 out of every $10 the authority has helped finance has gone toward either a health care or educational facility, according to the treasurer’s office.

“All of these projects would need to be done with taxable, higher-interest-rate financing, which makes it far less likely for them to pencil out,” says Laura Lockwood-McCall, the debt division director at the Oregon State Treasury.

The Council of Development Finance Agencies (CDFA) president, Toby Rittner, called the move “devastating” and said in a letter that eliminating private activity bonds “is bad policy [that] will cripple economic, infrastructure and community development.”

The bonds have received criticism in the past, and a 2013 New York Times article called them a “stealth subsidy for private businesses” because they were used for things like a golf course and office buildings.

But government stakeholders argue they overwhelmingly help finance needed projects. New York City's housing department, for example, tweeted on Friday that the state's tax-exempt housing bonds helped finance affordable housing for nearly 170,000 people over four years.

The tax bill doesn't stop at eliminating private activity bonds. It would also nix other types of bonds valued by state and local governments.

Among the most concerning to local leaders, it would ban governments from issuing what are called advanced refunding bonds. These bonds allow governments to refinance debt earlier than they would have otherwise, ultimately letting governments take advantage of lower interest rates years sooner. The bill also bans issuing tax-exempt bonds for sports stadiums, a proposal that had already been floated this year on Capitol Hill.

It's unclear exactly how much of the municipal market would be affected by the change, but experts say it would be a significant portion. According to Municipal Market Analytics' Matt Fabian, up to 20 percent of the $3.7 trillion municipal market is made up of private activity bonds. Making those bonds taxable would dampen future issuance.

When it comes to the advanced refunding bonds, Fabian says between 10 and 20 percent of all annual bond refinancings fall under that category. That means up to one-tenth of the total $386 billion in average annual bond issuance could be attributed to that type of bond.

The notion of eliminating the tax-free status of all municipal bonds has been a perennial topic in Congress for years. But when the Republican framework for tax reform preserved that status, municipal bond market users thought they had emerged unscathed.

Now, stakeholders are left scratching their heads.

The lobbyist for the Government Finance Officers Association told the *Bond Buyer* that the proposal never surfaced in more than 90 meetings on the Hill. Meanwhile, the CDFA worked for weeks with Democrats in Congress to introduce a new type of disaster recovery bond to aid residents and municipalities in rebuilding. That bill, also introduced this week, would be rendered obsolete under the latest tax plan.

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