Changes to Bond Rules in GOP Tax Bill Could Shake Up Infrastructure Financing.

WASHINGTON — The tax bill Republicans in the U.S. House are moving swiftly ahead with this week threatens to raise borrowing costs for health care facilities, affordable housing and other infrastructure projects involving states, local governments and nonprofit organizations.

The legislation would strip the tax-exempt status from a category of debt known as private activity bonds. State and local governments can issue these bonds as part of public-private partnership deals, and for 501(c)(3) nonprofits like hospitals and universities.

Because the interest earned on certain private activity bonds is not subject to federal income tax, investors buying the debt expect lower interest rates compared to taxable bonds.

In addition to the private activity bond rule changes, the GOP tax bill would eliminate a tax exemption for advance refunding bonds. State and local governments use these bonds to refinance debt at lower interest rates, which can save taxpayers money.

The tax bill would target private activity bonds and advance refunding bonds issued after 2017.

Emily Brock, who directs the Government Finance Officers Association's federal liaison center, said the effects of the bond-related provisions would be "immediate and severe." She also said the provisions caught the finance officers association by surprise.

"We conducted at least 90 Hill visits over the past couple months, just to get a sense of what this was going to look like," Brock told Route Fifty, as she discussed the tax bill. "Nowhere within those 90 Hill visits did we talk or discuss private activity bonds or advance refunding."

Natalie Cohen, managing director of municipal research with Wells Fargo Securities, said that not being able to issue tax-exempt private activity bonds would be "a handicap, for sure."

She flagged the elimination of the tax exemption for 501(c)(3) bonds as particularly significant.

"You're talking about hospitals, nursing homes, universities, charter schools," she said. Drug rehab centers, too, Cohen noted. "All of those would be precluded from the tax-exempt market."

In 2016, upwards of $72 billion in private activity bonds were issued for 501(c)(3) nonprofits, mainly hospitals and universities, according to the Government Finance Officers Association.

Linda Schakel is a partner who focuses on public finance issues at the law firm Ballard Spahr LLP.

As she discussed the possible consequences of eliminating the tax exemption for private activity bonds, Schakel pointed out that "if we're talking about hospitals who may be issuing $100 million in debt, that's going to add up and that cost has to be passed on some way."

"Most of their money comes either from the fees that they charge for their services or charitable contributions," she added.

The GOP tax bill would not alter the federal government's Low-Income Housing Tax Credit program. According to the U.S. Department of Housing and Urban Development, the program provides state and local agencies the equivalent of nearly $8 billion in budget authority each year to issue tax credits for the acquisition, rehabilitation, or new construction of rental housing for lower-income households.

But Schakel said projects that use the tax credit also frequently depend on private activity bond financing. And she predicted that without the tax exemption for the bonds, the number of rental units getting built through the Low-Income Housing Tax Credit program would go down.

Private activity bonds are different than standard, tax-exempt state and local municipal bonds that are regularly used to finance public works projects like bridge repairs and firehouses. These standard state and local bonds would remain tax-exempt under the GOP legislation.

Along with hospitals, universities and affordable housing, private activity bonds can be used to finance projects involving infrastructure that has both public and private elements or benefits—such as airports, docks and wharves and rail facilities. To be tax-exempt the bonds have to meet specific criteria spelled out in the federal tax code.

When state and local governments issue private activity bonds as part of public-private partnership deals, they effectively lend the borrowed money to the private sector partner taking part in the project, or there is some kind of long-term lease arrangement made.

For example, the Maryland Economic Development Corporation, a state entity, issued about $313 million in private activity bonds last year, as part of a light-rail project near Washington, D.C., with the intent of loaning the proceeds to the project's private developer.

The White House has promised an ambitious proposal for new infrastructure investment and Trump administration officials have signaled public-private partnerships will be a key element.

"This flies in the face of that," Cohen said of the GOP tax plan. "It significantly limits what can be financed through the tax exemption."

President Trump himself recently suggested during a meeting with lawmakers that public-private partnerships could be "more trouble than they're worth," according to news reports.

Congressional Republicans are working with tight margins as they seek to enact a tax code rewrite that cuts rates for corporations and individuals, while also adhering to a budget blueprint that calls for adding no more than $1.5 trillion to federal deficits over 10 years.

Eliminating the tax exemption for private activity bonds would increase federal revenues by an estimated $38.9 billion over a decade's time, according to a summary of the bill from the House Ways and Means Committee. Doing the same for advance refunding bonds would boost revenues by an estimated $17.3 billion.

The tax legislation would also block tax-exempt bonds from being put toward professional sports stadium and arena projects. This would raise another $200 million, the summary of the bill says.

The Ways and Means Committee's markup of the tax bill began on Monday and will continue on Tuesday.

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