Bond Case Briefs

Municipal Finance Law Since 1971

House Tax Bill Would Hit Nonprofits Hard.

Hospitals, university buildings and affordable housing projects could become much more expensive to develop if the tax plan approved Thursday by the Republican-controlled House becomes law.

The plan calls for eliminating a tax break on a type of bond financing used to build those and other projects, prompting worries by hospitals, colleges and housing groups that they could be forced to cut services, raise prices or cancel projects. They hope the Senate tax plan, which would not eliminate the tax break, comes out on top.

Nonprofits and affordable housing builders are able to borrow money by selling so-called private-activity bonds, which share an important feature with municipal bonds issued by government agencies to finance public projects: The interest income paid to bondholders is not subject to federal or state income tax.

Because of that tax exemption, investors are willing to buy bonds with lower interest rates, which means lower borrowing costs for bond issuers.

The House tax plan, by eliminating the federal tax exemption, would raise borrowing costs for new private-activity bonds.

Investment bankers and finance officers at nonprofits estimate the loss of the tax exemption could push up interest rates on private-activity bonds by 0.5 percent to 1.5 percent — a significant sum when the principal typically runs from the tens to the hundreds of millions of dollars.

Consider Keck Graduate Institute, one of the Claremont Colleges in California, which this year borrowed $52.6 million to build a 290-unit apartment building for students. The institute is paying about 4.7 percent interest on that private-activity debt.

Hugh Tanner, an investment banker at Raymond James who helped put the bond offering together, said Keck would have paid more like 5.7 percent if it had to issue taxable bonds.

Over the 30-year life of the bond, that extra 1 percent would add up to $14.8 million in additional interest, he said.

Those higher borrowing costs would trickle down to students. The institute plans to charge $1,360 for studios — below average for Claremont — but Tanner said rents would have to have been closer to $1,500 a month had Keck borrowed at the higher, taxable rate.

Kevin DeGood, director of infrastructure policy at the liberal advocacy group Center for American Progress, said cutting the bonds' tax exemption would hurt nonprofits across the country while providing little extra tax revenue.

The Joint Committee on Taxation, an arm of Congress, estimated that cutting the exemption would result in additional federal tax income of $39.8 billion over the next 10 years — a meager sum considering that the committee also estimates the tax plan as a whole will result in an overall reduction of federal tax income of $1.4 trillion over that period.

“If you’re a hospital, the additional interest you pay if your bonds are taxable has to come out of donations, out of patients, out of somewhere,” DeGood said. “There is no benefit to anybody to make it more expensive for a hospital to build a new wing. There is not a rational policy argument here. This is about hunting in the night for revenue to pay for egregious tax cuts.”

Private schools, too, could be pinched by higher borrowing costs.

Over the past 10 years, private colleges and universities in California — including the University of Southern California, Pepperdine, Stanford and several smaller schools — have borrowed $4.1 billion through private-activity bonds to build all manner of campus projects.

For affordable housing developers, who rank second only to hospitals in their use of private-activity bonds, the idea of paying higher interest rates is a secondary concern. Their biggest worry is that if these bonds become taxable, the change would have the secondary effect of killing one of the biggest funding sources for affordable housing projects: low-income housing tax credits.

There are two types of those credits, both of which give tax breaks in exchange for investing in affordable housing projects.

One of the types of credits, though, is available only to projects that are financed mostly with tax-exempt bonds. No tax-exempt bonds means a whole class of tax credits would effectively disappear.

Will Cooper Jr., chief executive of Irvine affordable housing investment firm WNC Inc., estimated that the combined loss of tax-exempt bonds and the related tax credit program could reduce the number of affordable housing units built in California by 200,000 over the next decade.

By James Rufus Koren / Los Angeles Times

Posted Nov 17, 2017