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Trump Tax Law Saved These Bonds, But IRS Sees Issuance Dwindling.

- **Private activity bond projects estimated to drop 27% by 2025**
- **Market has little faith Trump infrastructure plan will happen**

Tax advantages for bonds funding private hospitals and sports stadiums survived last year's tax overhaul thanks to an eleventh hour compromise. The securities may be headed for a decline anyway.

Projects financed by so-called private activity bonds, or PABs, are projected to fall by more than 27 percent over the next eight years, according to recent data from the Internal Revenue Service. Issuers may be concerned that PABs will be a target the next time lawmakers go hunting for revenue to offset a second round of tax cuts or extend other benefits.

The estimates also show the market has little faith that President Donald Trump's plan to rebuild America's infrastructure will ever become a reality. PABs are a key element of the administration's $1.5 trillion proposal released in February. But the plan has stalled amid Democratic criticism, and Trump has said any action on infrastructure will have to wait until after the November congressional elections.

There were 3,043 bond issues in 2017, a figure that is expected to decrease to 2,200 by 2025, the IRS said. The agency based its estimates on how many PAB tax forms have been filed in the past, while factoring in law and policy changes. Previously, the IRS has said it expected the number to stay at about 3,000 a year.

"There still continues to be an expectation that Congress may repeal or at least restrict certain categories of PABs," said Robert Capizzi, a partner at the law firm Chapman and Cutler.

The bonds are typically used by companies to inexpensively finance projects. Investors like them because they generate tax-exempt interest.

The House version of the 2017 tax bill called for abolishing the tax exemption for PABs, which prompted an outcry from state and local government officials. After a compromise with the Senate, the final version of the bill kept the bonds' benefits mostly intact.

Doing away with the exemption would save the government $38.9 billion over a decade, according to the Joint Committee on Taxation, Congress's official scorekeeper.

The tax law does eliminate the breaks for advance refunding bonds, which are vehicles used by state and local governments to refinance outstanding securities that can't yet be repurchased from investors.

So far, the tax law has had more effect on the demand side, rather than on the issuance side, said Chad Farrington, who heads municipal bond credit research at Columbia Threadneedle Investments.

Banks and insurers — who own about 25 percent of the private activity bond market — have less incentive to buy the bonds now because the tax law slashed the corporate rate and limited interest deductions, he said.

A lower corporate rate reduces the yield of a private activity bond as compared to a more liquid taxable bond, making private activity bonds less attractive to banks and insurers. The tax law also limited how much interest expense banks can deduct of the debt they incur to buy some bonds.

Airports and Aquariums

Private activity bonds are issued by state and local governments and other public authorities to give private entities access to tax-exempt debt for qualified projects like airports, toll roads, stadiums, zoos or aquariums. The private entity is required to pay back the bonds, typically with revenues from the project and usually without backing from the municipality. Investors don't have to pay income taxes on the interest on the bonds.

The bonds fund a range of projects including Bank of America Corp. and Goldman Sachs Group Inc.'s buildings in Manhattan. The Los Angeles airport, LAX, and the Barclays Center in Brooklyn have also received tax-exempt funding. Without private activity bonds, these projects would mostly be funded by taxable debt.

Generally, private activity bonds provide more yield than traditionally issued state and local government debt because they contain more risk than a security backed by property taxes or a dedicated revenue stream. They also act as way for investors to diversify their portfolios.

Critics of the bonds say PABs allow high-income individuals to avoid taxes and ultimately increase the federal deficit.

No 'Good Alternative'

Trade groups and analysts have mixed views on how the tax changes will affect the private activity bond market in the short term. Respondents to a Securities Industry and Financial Markets Association survey project long-term tax-exempt municipal issuance to reach $275 billion in 2018, a 23 percent drop from the $358.8 billion in expected issuance in 2017, the group said in a report.

The Council of Development Finance Agencies expects to see issuances in 2018 decline slightly from the record highs in 2017. Last year, there was a flurry of activity in December as issuers rushed to take action out of fear Congress would eliminate the tax break.

Trump made restoring American infrastructure a pillar of his campaign and promised $1.5 trillion in new investment. But his plan would provide only $200 billion in federal funding over 10 years to spur states, localities and the private sector to spend the balance of $1.5 trillion — with no identified way to pay for it.

The plan stalled amid Democratic objections that Trump's budget proposal would cut more than the $200 billion amount from other transportation programs.

If Democrats take control of at least one congressional chamber, it's likely Trump's plan as is would face opposition since it relies so heavily on private dollars.

"For infrastructure projects, there isn't a good alternative" to private activity bonds, said Tim Fisher, manager of government affairs at the Council of Development Finance Agencies. "Municipal bonds have been the backbone of American infrastructure since the end of the 19th century."

Bloomberg Markets

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October 9, 2018, 1:00 AM PDT

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