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Trump Infrastructure Plan May Undermine Municipal Market.

President-elect Donald Trump and a Republican-controlled Congress may take steps to make municipal bonds less attractive to investors, potentially undermining a popular tool to finance bridges, roads and other public projects.

Trump is calling for $1 trillion worth of infrastructure spending that would be financed in part through tax credits to investors and construction companies, Frank Shafroth, director of George Mason University's Center for State and Local Government Leadership, told Bloomberg BNA Nov. 29.

"Tax credits to investors insert federal, instead of state/local authority, guidance," Shafroth said. "It risks undercutting the planning of a state or local government."

A further concern for states and local governments is that Trump and Congress may move to tax municipal bonds to pay for credits or tax cuts in other areas. If that happens, expect states and cities to jump into the fray.

"Stated simply, state and local governments will want to preserve the existing rule for tax exemption of municipal bond interest because to eliminate it would increase the cost of borrowing," Charles S. Henck, a Ballard Spahr LLP partner who practices in public finance and tax law, told Bloomberg BNA Nov. 28.

The president-elect's transition team didn't respond to repeated requests for comment.

Trump Advisers

Trump economic advisers question whether state and local governments should be able to issue debt on which the interest is exempt from federal taxes.

Those advisers—private-equity investor Wilbur Ross and University of California at Irvine business professor Peter Navarro—argue that municipal bonds aren't an efficient way to pay for public projects. For one, a percentage of the money goes to the bondholder.

Navarro declined to comment for this story, and Ross, the billionaire who Trump is expected to nominate as commerce secretary, couldn't be reached.

Navarro and Ross, however, authored a paper during the general election campaign explaining problems with tax-exempt bonds and outlining alternative methods Trump is considering.

Private investment and federal tax credits could serve as a "critical" supplement to existing financial programs, public-private partnerships and Build America Bonds, the paper said.

Shafroth, however, said that a federal plan of private investment and tax credits may fail to take into account that states and local governments—unlike the federal government—have capital-planning processes and capital budgets that could be disrupted.

Cowboys, 'Big Dig.'

When investors buy municipal bonds, they are lending a local or state government money for a fixed period of time, often to pay for roads, schools and other construction projects.Arlington, Texas, for example, is paying off $300 million in bonds used to finance AT&T Stadium, home of the Dallas Cowboys. In Massachusetts, the governmental entity known as MassPort continues to pay for the "Big Dig," a $24 billion project that placed Interstate 93 under the city of Boston.

In exchange for an investment, the local or state governments pay the investor interest throughout the term of the bond. Currently, interest isn't taxable.

The investor is also entitled to the principal of the bond.

Spurred to Act

Generally, states don't involve themselves in Washington tax debates when Congress moves to repeal tax breaks or lower tax rates, because a broader tax base for the federal government means a broader tax base for states, Joe Henchman, vice president of legal and state projects at the Tax Foundation, told Bloomberg BNA Nov. 22.

But eliminating the bond interest exemption could make bonds—a favorite method of paying for large, expensive projects—less attractive to investors.

If the exemption is "on the table, states may get directly involved in the debate," Henchman said.

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