Bond Case Briefs

Municipal Finance Law Since 1971

Tax Bill Would Curb Municipal Bond Deals.

The list of infrastructure needs in Elkhorn, Wisconsin, is long: a decrepit public-works building, a century-old city hall and the all-important task of filling winter's bounty of potholes.

In October, Elkhorn scraped together $449,000 through a bond sale known as an advance refunding, a frequently used technique that allows debt to be refinanced years before it can be paid off. Such deals have become a mainstay of the $3.8 trillion municipal-debt market, accounting for about a third of the borrowing in 2016, saving state and local governments an estimated $3 billion that year alone.

"The more you pay in interest, the less you get done," said James Heilman, finance director for Elkhorn, a city of 10,000 residents about 47 miles southwest of Milwaukee. "We never have a lack of needs as far as infrastructure goes — what we have is a lack of money."

But his town's representative in Congress — House Speaker Paul Ryan — may take away that tool. The broad overhaul the Republican shepherded through his chamber would tax the income from bonds sold for advance refundings, a step that would effectively make them no longer viable because investors would demand higher yields to buy the securities.

That's not the only way the cost of the federal tax cuts would ripple down to local governments. Both the House and the Senate proposed limiting — or eliminating outright — the deduction for state and local taxes, which may make it more politically difficult for governments in high-tax states like New York to raise them further. The House bill would also make it more expensive to build airports, hospitals and affordable housing by preventing businesses from borrowing in the tax-exempt market.

But doing away with advance refundings would eliminate a crucial tool that's saved governments tens of billions of dollars since interest rates tumbled after last decade's recession. The process involves issuing new bonds, buying Treasurys and using the income to cover debt-service bills as they come due — rather than paying the bonds off all at once, as homeowners do when refinancing mortgages. The savings can free up money for public works or help keep tax increases at bay.

The change will do little to cover the cost of tax cuts that will add $1.4 trillion to the deficit over the next decade, according to Congress' Joint Committee on Taxation. The committee estimates that eliminating the subsidy for advance refundings will raise about $17 billion in revenue through 2027.

"We're not even sure that federal policymakers understand the impact," said Matthew Chase, executive director of the National Association of Counties. "We think this was grabbing numbers off a spreadsheet as revenue raisers without really understanding the scope of the market."

The impact will be felt equally in urban, Democratic districts and Republican strongholds in the suburbs and fast-growing regions of the south. Lexington School District One, in central South Carolina, used advance refundings to avoid property-tax increases, said John Butler, its chief financial officer. The district, which serves over 25,000 students, will save more than $10 million from one done earlier this year.

“If they don’t keep them tax-exempt, in the long run the school district will end up paying more interest on the bonds and that will cause the taxpayer to pay more taxes,” he said.

While the Senate and House plans differed on some details, both chambers backed the curbs on advance refundings, indicating it’s likely to remain in the final version of the legislation.

The opposition from local governments wasn’t much of an obstacle in the House. Rep. Joe Wilson, a Tea Party-backed Republican from South Carolina’s Lexington County, said the House bill was an overall win for residents of his district.

“It lets families keep more of the money they earn, stops American jobs from moving overseas and gives small businesses more room to expand,” he said in the emailed statement. “Reducing taxes promotes cycles of new jobs, new housing, and new investments in real estate, growing the tax base and the economy.”

Rep. Terri Sewell, an Alabama Democrat and former bond lawyer who serves on the House Ways and Means Committee, offered an amendment that would have kept the refundings tax-exempt, only to see it struck down. The deals have drawn criticism in Congress for being costly to the Treasury by simultaneously subsidizing the original bonds and those issued to refinance that debt.

Sewell called that critique “ridiculous,” saying she has seen firsthand how lowering debt costs can help communities and nonprofits. “For the life of me I can’t understand why the Republicans would go after these useful tax incentives,” she said. “Why would we discourage the ability to have savings?”

Cities, states and nonprofits have started to flood the market with bond sales to refinance before the legislation becomes law, pushing the calendar of offerings over the next month to the highest in 13 months.

AshLee Strong, a spokeswoman for Ryan, said if it’s enacted governments will still be able to sell low-cost tax-exempt debt for construction projects. “State and local governments will be able to continue financing important public works projects,” she said in an email.

But Heilman, the finance director of Elkhorn, said the shift will prevent cities like his from freeing up needed cash by taking advantage of lower interest rates when the opportunity arises.

“I don’t think there’s a community in this country that couldn’t use to do a little more infrastructure work,” Heilman said. “Or if it’s a little bit of savings on their tax roll, that’s not a bad thing either.”

The Associated Press

November 29, 2017