

# **Bond Case Briefs**

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## **GFOA: Potential Impacts of Tax Reform on Outstanding and Future Municipal Debt Issuance.**

Passage of the tax reform bill in December 2017 eliminated state and local governments' ability to use tax-exempt bonds to advance refund outstanding bonds, as of January 1, 2018. An advance refunding occurs when bonds are refunded more than 90 days prior to the optional redemption, or "call," date of the outstanding bonds. Tax-exempt advance refundings offered an important tool for state and local governments to reduce debt service costs, freeing up resources to be used for other important purposes, and minimizing taxpayer and ratepayer burdens<sup>1</sup>. Advance refundings are also utilized to restructure debt service payments or address problematic bond terms and conditions, if needed.

Federal tax laws previously provided issuers an opportunity to advance refund bonds on a tax-exempt basis. Since 1985, issuers were permitted a single advance refunding prior to the call date of the bond. In 2017, advance refundings represented approximately 20% of total tax-exempt municipal bond issuance. Market solutions seeking to provide similar outcomes to that of previous tax-exempt advance refundings are emerging, as are changes to new bond issuances. Issuers should work with their advisors to understand potential new risks and other considerations that may accompany these alternatives.

GFOA best practices recommend utilizing the skills and expertise of [Bond Counsel](#) and [Municipal Advisors](#) in making financing or refunding decisions. GFOA also cautions many entities against entering into [swap or derivative agreements](#).

*<sup>1</sup>Federal regulations continue to allow issuance of tax-exempt current refunding bonds, where outstanding bonds may be refinanced on a tax-exempt basis within 90 days of the optional redemption, or "call," date of outstanding bonds.*

**The following offers preliminary considerations for the issuer when working within the new tax laws:**

### **Considerations for Outstanding Bonds**

Market participants will likely recommend previously utilized tools or develop new tools or mechanisms to simulate the beneficial impacts of tax-exempt advance refundings. Potential alternatives may include taxable advance refundings, interest rate locks, forward-purchase agreements, or other options. Issuers should be particularly mindful of the unique risks and uncertainties associated with these options, and discuss these options with their municipal advisors and legal counsel. Additionally, issuers wishing to refund Build America Bonds (or similar tax credit subsidy bonds) will need to consult with their legal counsel and municipal advisors before proceeding.

Issuers should also be aware that outstanding bank loans or direct placements could be impacted by tax law changes that reduced corporate tax rates. "Gross up" provisions included in many bank loan agreements may result in increased interest costs effective immediately, and issuers should discuss

possible solutions with their debt management team. Bank waivers or modifications of gross up provisions may trigger “reissuance” of the obligations.

### **Considerations for Future Bond Issues**

Governments preparing to issue new municipal bonds may feel compelled to pursue issuance alternatives that provide early refinancing options in the absence of tax-exempt advance refunding provisions. These alternatives may include use of shorter call features, bullet maturities, derivative products and variable rate financing options. The same alternatives could also be pursued with current refunding bonds.

Issuers should be certain that specific benefits, risks, and costs of any financial tool are fully understood and are consistent with the entity’s debt policies. For example, shorter call features may come with an increased cost premium at the time of issuance, or other material changes to terms or costs. Performing diligent cost-benefit analysis of call features is likely to increase in importance.