Muni advocates spell out costs of ending tax-exemption

Scott Sowers

"Tax exempt municipal bonds are a critical financing tool for county governments, allowing investment in large-scale infrastructure projects at a lower cost to taxpayers," said Mark Ritacco, chief government affairs officer for the National Association of Counties. "Counties are urging Congress to preserve the tax-exempt status of municipal bonds to avoid significantly shifting infrastructure costs onto state and local governments, and most importantly our residents."

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The backlash to a possible elimination of the tax-exempt status of municipal bonds is reverberating with investors, affordable housing advocates, and issuers who are strategizing on their response.

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The threat to tax-exempt munis are laid out in a 50-page list circulating through Congress that includes a wide range of targets for a possible budget reconciliation aimed at raising federal revenue and cutting spending.

The list estimates that removing the tax exemption would save $250 billion over a 10-year timeframe. Private activity bonds, which play an integral role in the capital stack for financing affordable housing are also on the list.

The savings for ending the "tax preferences" for PABs and other non-municipal bonds is estimated at $114 billion savings over ten years.

Opponents to tinkering with the items on the list point out that the costs of reducing the appeal of PABs is not without downsides.

"If the tax-exemption were curtailed, housing costs would increase immediately and significantly for first-time homebuyers and providers of affordable rental homes in every state in the country," said Stockton Williams, executive director of the

National Council of State Housing Agencies.

To tap Low Income Housing Tax Credits, the financing must include at least 50% PABs. Some muni leaders see a move to cut PABs as low-hanging fruit in the budget battle.

"We are very concerned about any changes to private activity bonds that could in any way limit our ability to access 4% housing credits," said Emily Cadik, the CEO of the Affordable Housing Tax Credit Coalition.

"Repealing or changing private activity bonds in such a way that would actually decrease affordable housing production would make an already vast and growing crisis worse."

The possibility of funding cuts was made more real last week when an OMB directive temporarily stopped federal funds flowing to state and local governments. Funding for major infrastructure projects are often matched by reimbursements from the federal government and initially sparked by an issuance for tax-exempt munis.

"Municipal bonds are a critical resource for local governments to fund critical infrastructure projects, including public transportation," said a spokesperson for the American Public Transportation Association.

"We are working with coalition partners to ensure that Congress and the Trump Administration understand the critical importance of this financing tool to building America's infrastructure."

The strategy for keeping tax-exemption in place includes a flurry of fly-ins and door knocking on Capitol Hill by the industry's lobbyists.

"We are hearing nothing but strong support for tax-exempt housing bonds from members on both sides of the aisle, which is encouraging," said Williams.

"Congress' work to craft the tax bill and ours to ensure bonds are protected and enhanced in it will unfold over the next several months."

The investment side of the business is also engaged and showcasing numbers revealing the extra costs of a tax exemption repeal.

"The elimination of the tax-exemption would increase the infrastructure gap in the U.S.," said Tom Kozlik, the managing director and head or public and municipal strategy for Hilltop Securities.

"Borrowing rates for infrastructure would rise an additional $824 billion, a cost that would be passed onto U.S. taxpayers and amount to a $6,555 tax and rate increase for every American household over the next decade."

The numbers come from estimates prepared by the Government Finance Officers Association.

The implications of a tax-exempt repeal may warn off the budget cutters searching for easy pay-fors.

"Market participants are increasingly concerned about the potential jeopardy of the tax exemption in the new Congress," said Pat Luby, senior municipal strategist, CreditSights.

"While we acknowledge that the risk of a complete elimination of the municipal bond tax exemption is higher than it has been in decades, potentially unprecedented, we contend that the financial burden on state and local government borrowers, coupled with the increased cost of essential infrastructure funding, will likely dissuade congressional negotiators from pursuing a total restriction on tax financing."