



STATEMENT FOR THE RECORD

**United States Senate Committee
Hearing on "Early Impressions of the New Tax Law"
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Introduction:

The Bond Dealers of America (BDA) appreciates the opportunity to comment on its early impressions of the new tax law. The BDA is the only Washington, DC –based trade association representing the interests of “main-street” investment firms and banks active predominately in the U.S. fixed income markets.

The BDA applauds the Committee and Congress for passing sweeping tax reform legislation, the *Tax Cuts and Jobs Act*, which will further stimulate the United States economy, while increasing opportunities for growth in areas such as corporate investment. Specifically, we appreciate that the final bill maintained the tax-exempt status for governmental municipal bonds and private activity bonds (“PABs”), including all bonds for 501(c)(3) organizations, healthcare, multi and single-family housing, and higher education. We strongly urge the Committee and Congress to expand the eligibility of private activity bonds to provide state and local governments the flexibility needed to provide infrastructure efficiently and effectively, and at low cost for the taxpayer.

However, the BDA and a wide-array of stakeholders were deeply alarmed that the *Tax Cuts and Job Act* fully repealed tax-exempt advance refunding bonds upon enactment of the legislation into law. The repeal of this provision is working against the stated goal of the *Tax Cuts and Jobs Act*, to energize the economy and lower the tax burden of middle-class Americans. Moreover, the significant change would restrict the primary tool that is widely and frequently used as part of financing America’s infrastructure.

As a result of the quick enactment of the *Tax Cuts and Job Act*, several critical provisions, including advance refundings, were prohibited by the law without

critical public policy considerations. The BDA also recognizes that the Committee and Congress acted to eliminate various tax provisions to minimize the fiscal pressure the federal government is facing. The BDA believes that the projected federal savings from the repeal of advance refundings in the tax bill is lower than the JCT score of \$17 billion, in part due to the rush of issuers into the market in the latter part of 2017 and slowly rising interest rates. In addition, the modest increase in federal tax revenue does not outweigh the public benefit of this provision.

A bipartisan bill, *To Reinststate Tax-Exempt Advance Refunding Bonds*, (H.R. 5003), has been recently introduced in the House. According to the bill sponsors, “the legislation would restore advance refundings so that states and local governments can take advantage of favorable interest rates and more efficiently manage their financial obligations.” The BDA strongly urges the Senate to introduce a companion bill to H.R. 5003.

Advance Refundings:

State and local governments routinely refinance their outstanding debt obligations, just as corporations and homeowners do. The advance refunding technique allows state and local government issuers to benefit from lower interest rates when the outstanding bonds are not currently callable. It is important to note, that under previous law, tax-exempt bonds could be issued to advance refund an outstanding issuance only once, a significant restriction on these transactions.

According to recent Government Finance Officers Association (GFOA) data, between 2012 and 2017, there were over 9,000 advance refunding issuances nationwide, saving taxpayers over \$14 billion in the five-year period. We note that this represents the “present value” measurement of the savings and the actual savings are substantially greater. The data also works to disprove a myth that only large municipalities benefit from the cost savings. For example, in Montgomery County, TX, there were 6 instances of advance refunding for Conroe primary and secondary education that resulted in a cost savings of over \$20 million dollars. In Barrington, IL, the city issued \$300,000 in advance refunding bonds for parks and in Eden Prairie, MN a \$250,000 issuance of general purpose bonds were advance refunded.

Tax-exempt municipal bonds play an integral role in financing our nation’s infrastructure. This safe investment benefits every aspect of American life, from roads and bridges, to public safety and healthcare. In an age of declining direct federal funding, the municipal bond market drives new construction and maintenance of current infrastructure.

In addition, federal analyses of such tax-exempt bond proposals focus solely on federal tax revenues to be raised by such proposals, ignoring the effect on state and local governments and, thus, state and local residents. Private sector analyses, however, confirm that taxing municipal bonds, in whole or in part, or replacing

municipal bonds with some other financing tool will increase state and local financing costs.

Consequences of the Repeal of Advance Refundings:

The repeal of any portion of the tax code has major consequences, intended and unintended, short-term into long-term. The immediate impact of this policy decision to eliminate advance refundings was to provide a portion of the pay-for for a massive tax-code overhaul. While there are a plethora of policies included in the overall bill that are beneficial to the U.S. economy as a whole, the elimination of municipal advance refundings increases the cost and burden on state and local governments nationwide.

An example of this cost savings occurred in the Village of North Barrington, IL. The town advance refunded a debt issuance for sanitary sewer improvements. The refinancing saved residents \$310,000 over a 10-year period. The savings was realized in annual property tax collected by Lake County.

The loss of municipal advance refundings will severely impact the financing of core public services and infrastructure in the State of Texas. More than 50 issuers including cities, schools hospitals, and water and public transportation boards in the five largest counties in Texas (Bexar, Dallas, Harris, Tarrant, and Travis) will lose the ability to advance refund an estimated \$6.6 billion dollars in bonds over the next two years. The repeal of this vital financing tool translates into a loss of millions of dollars that would have been reinvested back into these communities.

Another specific example in Texas is the Port of Galveston, TX, which was planning to advance refund a \$11.3 million issuance in bonds that would produce a cost savings of \$450,000. As a major transportation and trade hub for the central United States, additional capital was not leveraged to compete and continue to be an economic driver in the western Gulf of Mexico.

The Macomb County Michigan Drainage District is missing an opportunity to advance refund over \$20 million in bonds and realize upwards of \$1.3 million in savings. As the State of Michigan continues to deal with an ongoing water crisis and an overall budget shortfall, the State and its local governments are feeling the negative effects. The inability to advance refund this issuance makes local officials' jobs more difficult.

It is worth noting that the full impact of the repeal of the ability to advance refund tax-exempt bonds will be somewhat delayed. Due to the low interest rates at the end of 2017 and the pending repeal of the ability to advance refund bonds, many state and local governments refinanced their bonds prior to year-end. As a result, there will be a relatively short period during 2018 before state and local governments feel the real impact of this change in law. However, this delay should not be interpreted to indicate that the repeal will not have significant, long-lasting impacts on state and local governments.

On a long-term basis, State and local governments will be significantly disadvantaged by the loss of the ability to issue tax-exempt advance refunding bonds. Most importantly, they will have lost the most efficient mechanism to take advantage of low interest rates to refinance higher rate debt in advance of when such debt can be called. The inability to lock in lower interest rates when they are available will, simply stated, result in increased costs to these governmental entities. Moreover, both at times of relatively low rates and otherwise, state and local governments have lost an important means of restructuring their outstanding debt to respond to short or long term fiscal issues (which can include both paying off their debt more quickly or restructuring debt to deal with short term financial difficulties).

Given the number of advance refundings completed at year-end, the use of alternatives to advance refundings has been slow to develop in 2018. While there are some alternatives, none are as effective in terms of cost or risk as advance refundings. For example, “forward starting” interest rate swaps can be used to effectively lock in current interest rates but state and local governments are hesitant to use interest rate swaps. Other alternatives are more costly than advance refundings and, for that reason, were not used to a significant degree in the past. While these structures may mitigate some negative impacts of the recent change in policy, their long-term impact and viability will not be to provide an effective replacement for advance refunding bonds.

Expansion of the Use of Private Activity Bonds:

The BDA strongly supports the expansion of the types of infrastructure facilities that are eligible to use tax-exempt PABs beyond the existing types, lifting the volume caps, and eliminate other restrictions such as the governmental ownership requirement for certain eligible facilities that apply under current law. Tax-exempt PABs permit a greater degree of private sector involvement in infrastructure projects and programs that provide important public benefits that should be preserved and enhanced. By expanding the use of current infrastructure tools like PABs, rather than creating new financing methods such as a federal infrastructure bank (and the associated bureaucracy), these changes would help propel local communities forward, facilitate the ability of state and local governments to partner with private entities in a variety of projects, finance new infrastructure, and help maintain local control of much needed projects in their communities.

The BDA urges you to oppose federal legislative proposals that would restrict the tax exemption of municipal bonds. Past proposals released or discussed in the last two Congresses have sent tremors through the municipal markets and have increased interest rates on tax-exempt bonds. The perceived risk to the tax exemption led some investors to seek higher yields on municipal bonds and to pull much-needed capital and liquidity out of the municipal markets. This, in turn, forces municipal governments to pay significantly higher borrowing costs—and the

continuing domino effect forces some governments to reduce or abandon infrastructure projects they can no longer afford.

Conclusion:

For over 100 years, municipal bonds have served as the primary financing mechanism for public infrastructure. Nearly three-quarters of the nation's core infrastructure is built by state and local governments, and imposing an unprecedented federal tax on municipal bonds, including advance refundings, will make these critical investments more expensive while shifting federal costs onto state and local governments, and the people they serve.

In the Trump Administration's "Legislative Outline for Rebuilding Infrastructure in America," municipal bonds were featured as a central pillar, and the outline included strengthening PABs. While this is a move in the right direction, the BDA recommends the reinstatement of advance refundings to further spur growth. Reinstating advance refundings would be one of the wisest and most cost-effective investments that Congress can make to finance ongoing infrastructure needs for state and local governments and ultimately, the constituents of all Congressional representatives.

The ability to advance refund bond issuances benefits all Americans and creates infrastructure investments that provide high quality jobs and spurs economic growth nationwide.

As the debate on infrastructure and the financing mechanisms behind the desired increase of funding continues, it should be remembered and recognized that state and local governments are currently under a time of fiscal strain due to the elimination of the state and local tax deduction (SALT). This change in federal tax policy will put downward pressure on state and local governments to lower taxes due to the direct increase in tax burden that their constituencies will face. In addition, a vast number of state and local governments must work under a balanced budget system. The elimination of advance refunding removes a vital cost-savings financing tool and in consequence, state and local governments are forced to raise state and local taxes or reduce public service programs.

In conclusion, the BDA urges the Committee to reincorporate the cost-saving mechanisms of municipal advance refundings back into the U.S. tax code and consider a Senate companion bill to H.R. 5003.

In addition, as the Committee continues its examination of the *Tax Cuts and Jobs Act*, we strongly urge you to consider the positive issuer, investor, market, and economic implications of expanding the eligibility of private activity bonds to provide state and local governments the flexibility needed to provide services efficiently and effectively, and at low cost for the taxpayer.