After Tax Reform: Municipal Market Update & Considerations

Fundamentals of Public Finance Seminar

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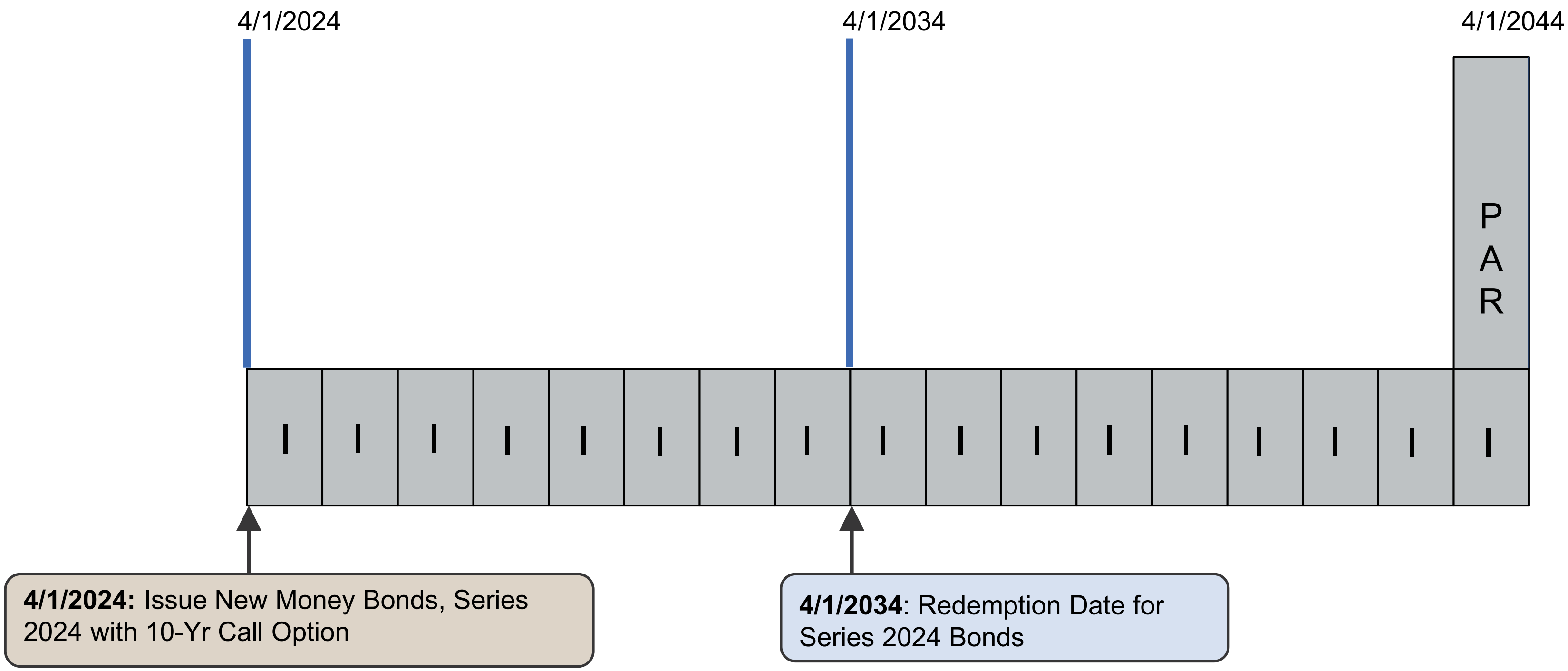
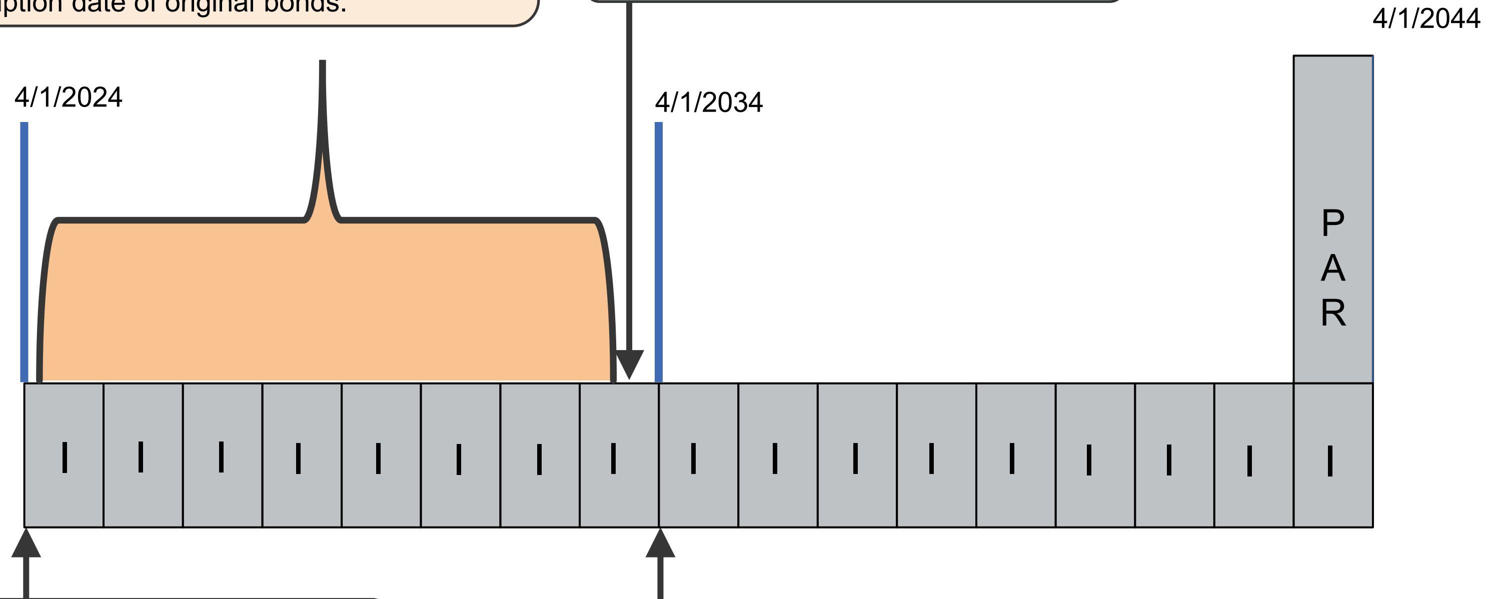
Setting the table: Advance vs. Current Refundings



Setting the table: Advance vs. Current Refundings

4/2/2024–12/31/2033: advance refunding period (**>90 days prior to call date**). Refunding escrow funded by new bonds, escrow pays existing bonds' debt service through redemption date of original bonds.

1/1/2034: **90 days prior to call date**, start of current refunding period.



4/1/2024: Issue New Money Bonds, Series 2024 with 10-Yr Call Option

4/1/2034: Redemption Date for Series 2024 Bonds

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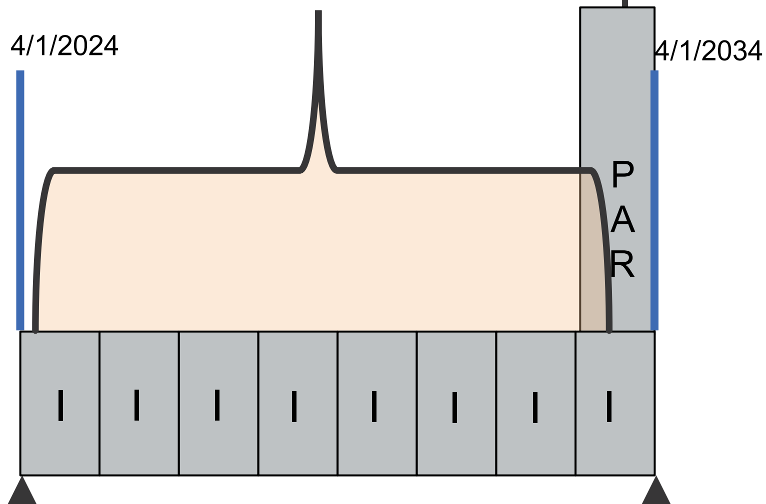

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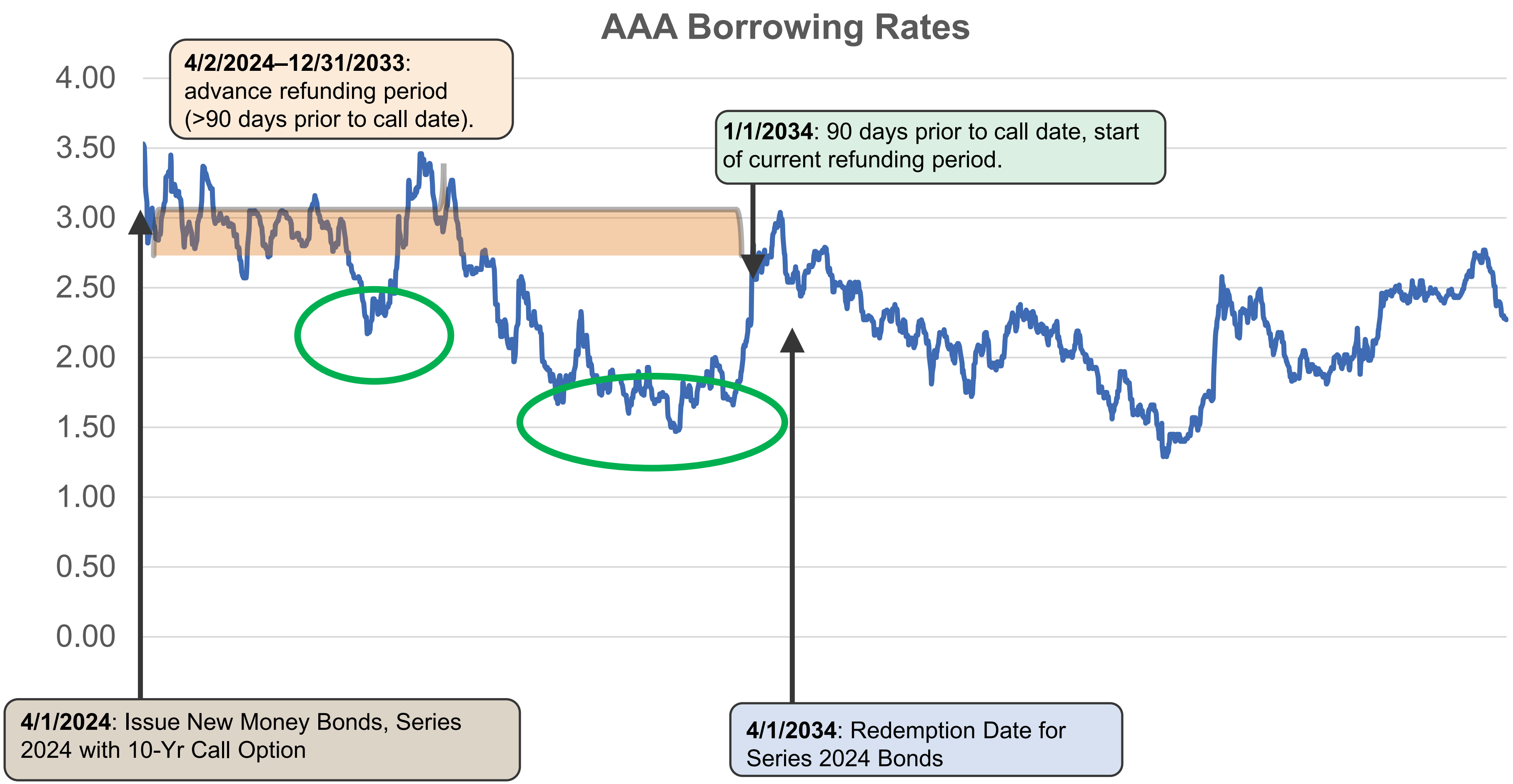
4/1/2034: Redemption Date for Series 2024 Bonds

Advance refunding = flexibility + opportunity



Poll question #1

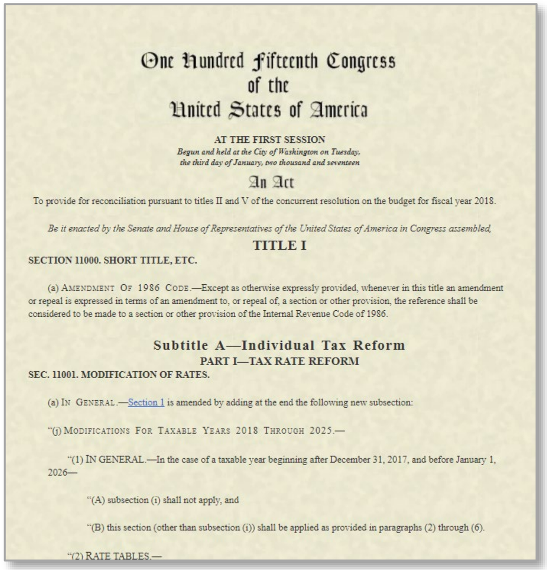
- Characteristics of advance refundings include:
  a) The existence of two tax-exempt bond issues at one time, with refunded bonds funded by an irrevocable refunding escrow.
  b) Allows issuers to take advantage of low rate environments, any time prior to the redemption date of original issued bonds.
  c) None of the above (a and b)
  d) Both of the above (a and b)

Municipal Bond Market Impacts of Tax Cuts & Jobs Act of 2017

- The 2017 Tax Cuts & Jobs Act had significant impacts on the municipal market.

As initially proposed, the tax reforms proposed elimination of:

- Tax-exempt private activity bonds
- Tax-exempt advance refundings
- New tax credit bonds
- Tax-exempt stadium bonds



One Hundred Fifteenth Congress
of the
United States of America

AT THE FIRST SESSION

Begun and held at the City of Washington on Tuesday, the third day of January, two thousand and seventeen

An Act

To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I

SECTION 11000. SHORT TITLE, ETC.

(a) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

Subtitle A—Individual Tax Reform

PART I—TAX RATE REFORM

SEC. 11001. MODIFICATION OF RATES.

(a) IN GENERAL.—Section 1 is amended by adding at the end the following new subsection:

"(j) MODIFICATIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—

"(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

"(A) subsection (i) shall not apply, and

"(B) this section (other than subsection (i)) shall be applied as provided in paragraphs (2) through (6).

"(2) RATE TABLES.—

SPARED from tax reform:

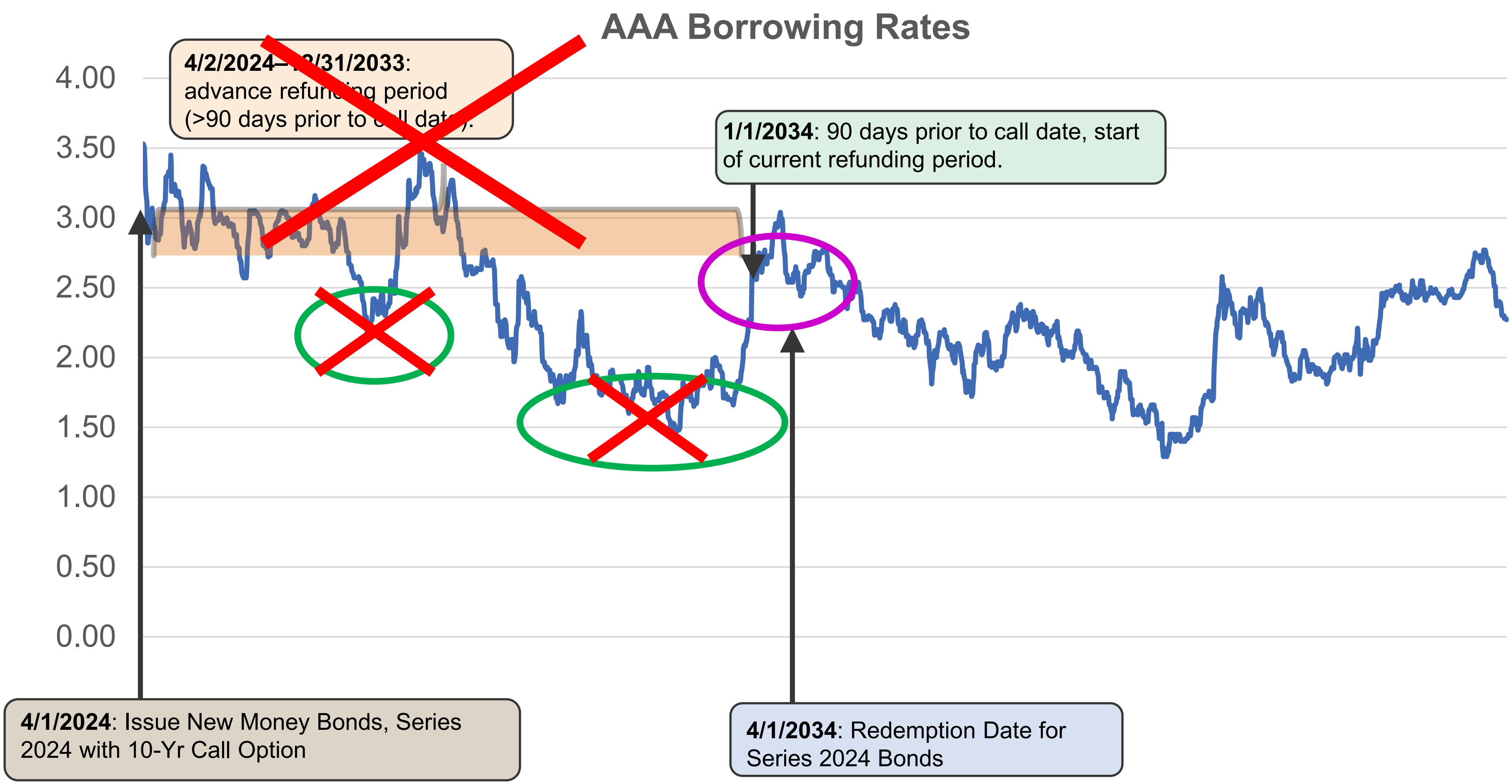
- Private activity bonds
- Stadium bonds

ELIMINATED through tax reform:

- Tax-exempt advance refundings
- New tax credit bonds
- Additionally, lower tax rates for corporations (21% from 35%) and individuals could lead to a drop in demand for municipal bonds or higher return requirements (i.e., higher rates) from investors

Source: Jobs Act of 2017

Elimination of tax-exempt advance refundings



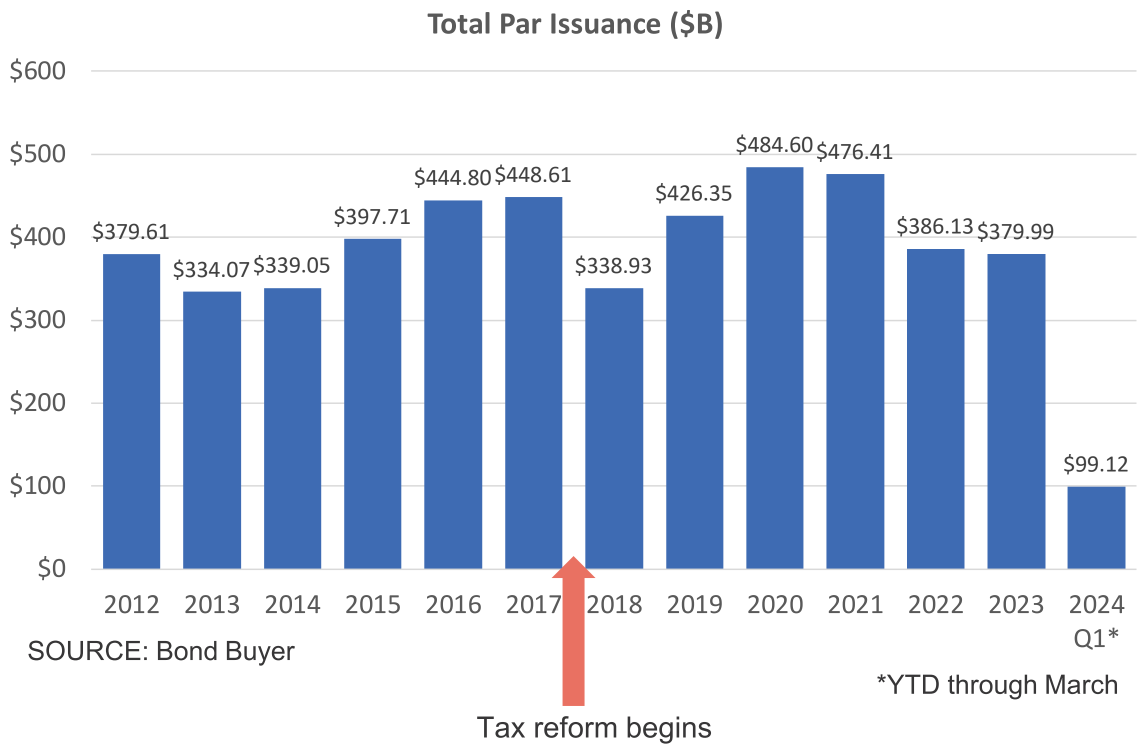
For illustrative purposes only

Poll question #2

- The Tax Cuts & Jobs Act of 2017 had major impacts on the municipal market through:
  a) Prohibiting the use of tax-exempt advance refunding bonds.
  b) Eliminating the use of tax-exempt bonds to fund professional sports stadiums.
  c) Lowering tax rates for corporations and individuals, decreasing the value of tax exemption.
  d) Eliminating the use of tax-exempt private activity bonds.
  e) All of the above
  f) A and C only.

2019 - 2024 – A Changing Market

- 2017 saw a spike of muni issuance volume as issuers flooded the market in December after the tax reform package was announced.
  - $144.6 billion in Q4 (33% of full year amount)
  - $62.5 billion in December (1,168 transactions) – a new record
    - 3x higher dollar volume than December, 2016
    - Previous monthly issuance record: $54.7 billion (December, 1985)
- 2018 saw a dip in issuance volume (down 24%) with the elimination of advance refundings and the surge in late 2017.
- Issuance volume rebounded in 2019 with issuance volume growth through 2020-2021, before a slower pace of issuance in 2022 and 2023 due to inflation, market volatility, and higher interest rates.



SOURCE: Bond Buyer

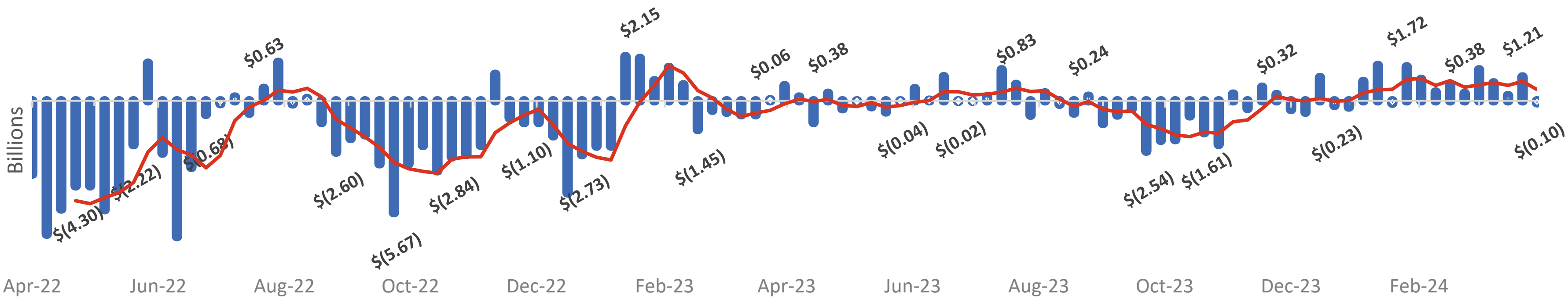
*YTD through March

2024 Municipal Market Update – volatility, higher rates and lower volume

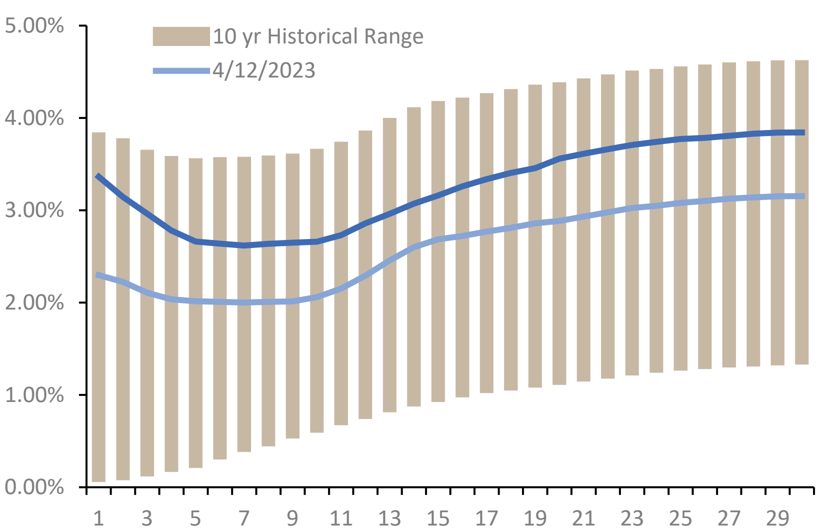
- Following the strong issuance environment and robust issuance volume throughout the COVID-19 pandemic, largely driven by historic low rates and federal stimulus packages, rates increased sharply beginning in January of 2022 and have remained elevated through and including the current market.
- Increases in rates and volatility in the markets are largely due to:
  - Increases in inflation levels and ongoing challenges to reverse the trend
  - FOMC rate increases
  - Geo-political events
- While 2024 is an improvement on 2022 and 2023, the municipal investor supply-demand dynamic has become more volatile, with greater swings in intra-day muni-fund inflows and outflows.
- Economic factors (e.g., inflation, potential for recession or a “soft landing”) and FOMC activity will continue to drive the market through 2024.

2024 Municipal Market Environment

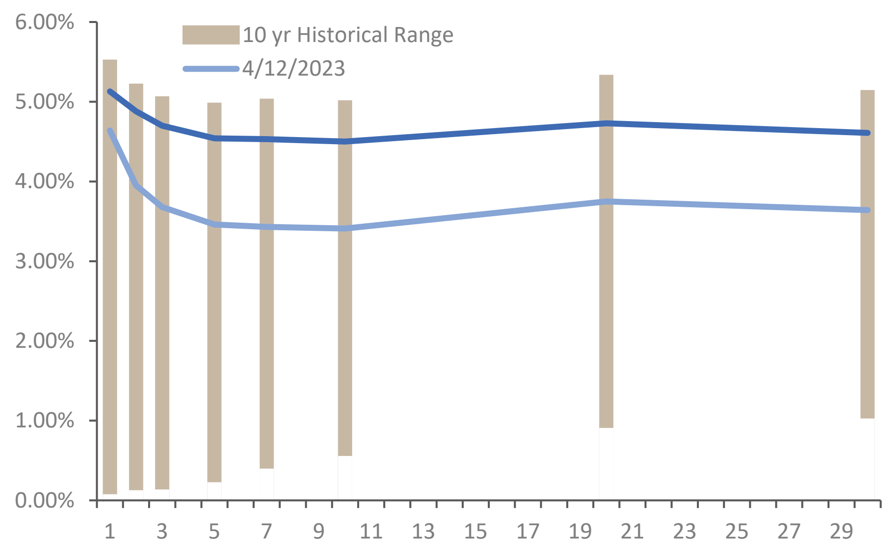
ICI Weekly Fund Flows (Past 24 Months)



AAA Municipal Curve

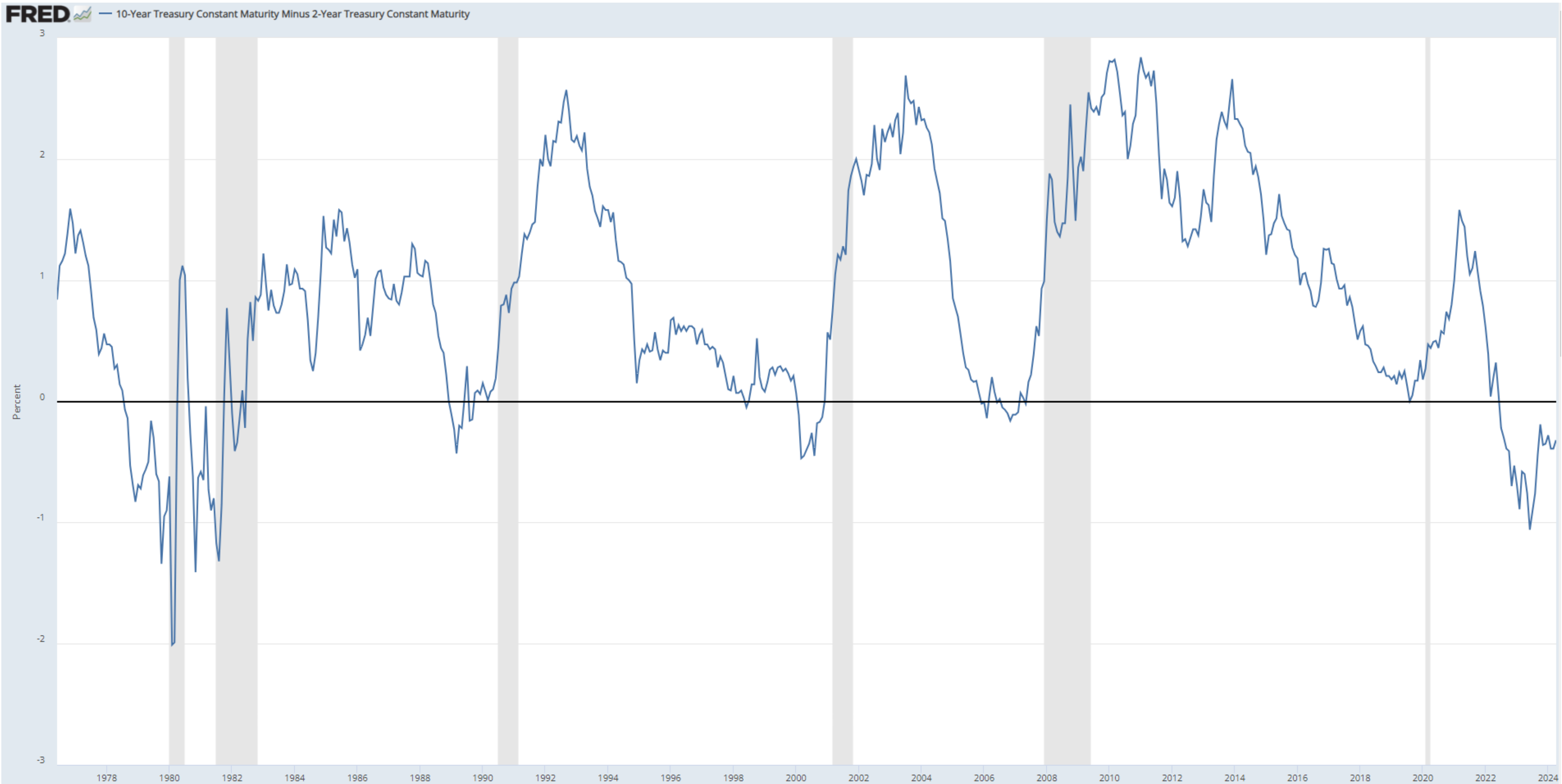


U.S. Treasury Curve



Source: Bloomberg

Where will the Fed go? Recessionary risks.



Source: FRED, Federal Reserve Bank of St. Louis

Poll question #3

- Which of the below statements is **false**:
  a) Historically low interest rates existed during the COVID-19 pandemic.
  b) Rates have remained low through the current market.
  c) Investor demand for municipal bonds diminished beginning in 2022, with muni-fund outflows leading to market volatility and higher borrowing costs for municipal bond issuers.

Proposals for restoration of tax-exempt advance refundings

- Discussions continue to occur, at varying levels of buy-in, regarding new legislation that would provide significant benefits to municipal bond issuers and their constituents.
- Proposals have included:
  - Restoration of tax-exempt advance refundings.
  - An increase to the annual cap on Bank Qualified bonds from the current $10 million to $30 million.
  - Creation of America Infrastructure Bonds, which like Build America Bonds from the last financial crisis, would allow issuers to issue bonds on a taxable basis and receive direct payments from the federal government, offsetting their interest costs by amounts ranging from 42% to 30%.
  - An increase the use of Private Activity Bond financing for multi-family housing projects.
- While these proposals have failed to gain traction within the many legislative packages passed during the COVID-19 pandemic, market advocates and participants continue to work with supportive members of Congress and the Administration for consideration of these proposals that would benefit municipal bond issuers and their constituents.
- It is important that we all continue to remind the public and lawmakers of the importance of tax-exemption.

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