After Tax Reform: Municipal Market Update & Considerations

Fundamentals of Public Finance Seminar

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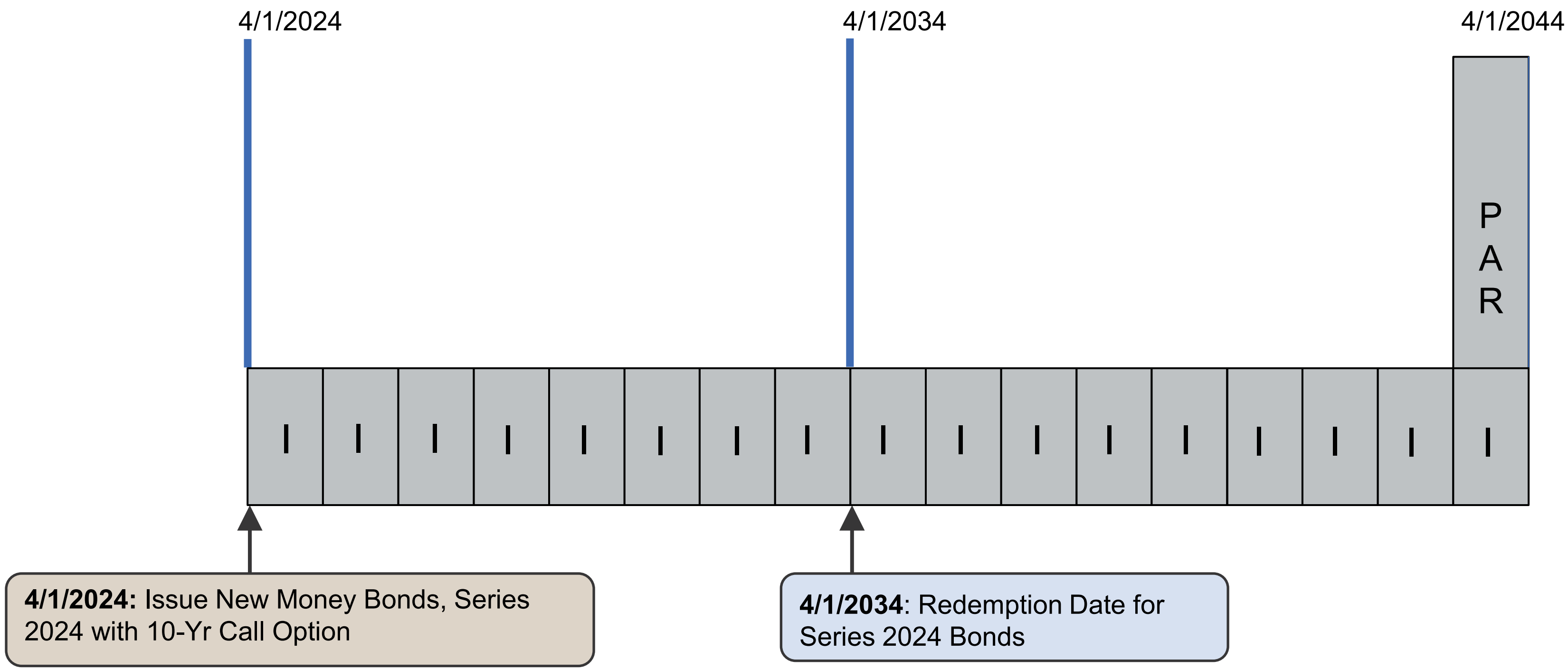
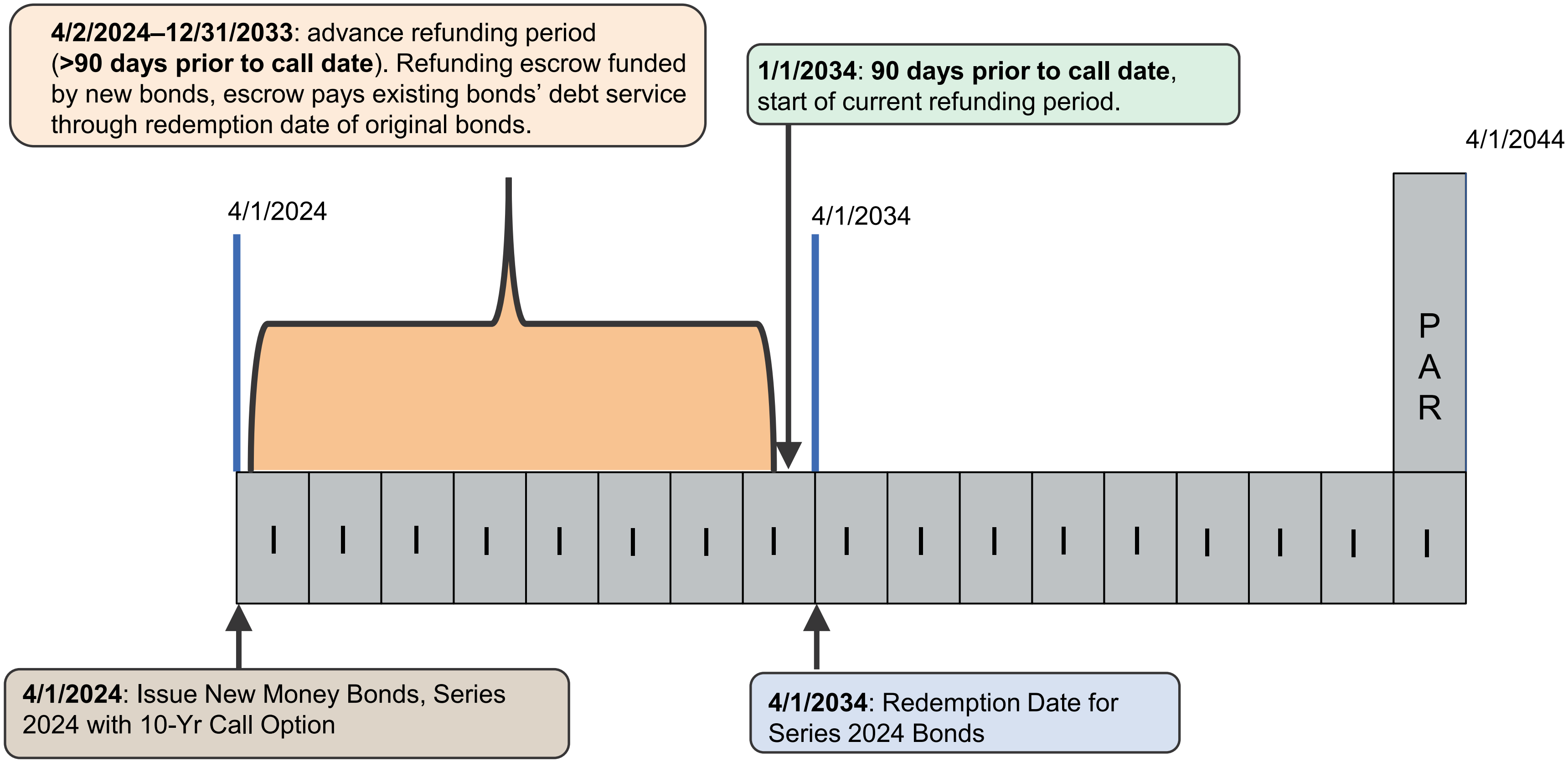
Setting the table: Advance vs. Current Refundings



For illustrative purposes only

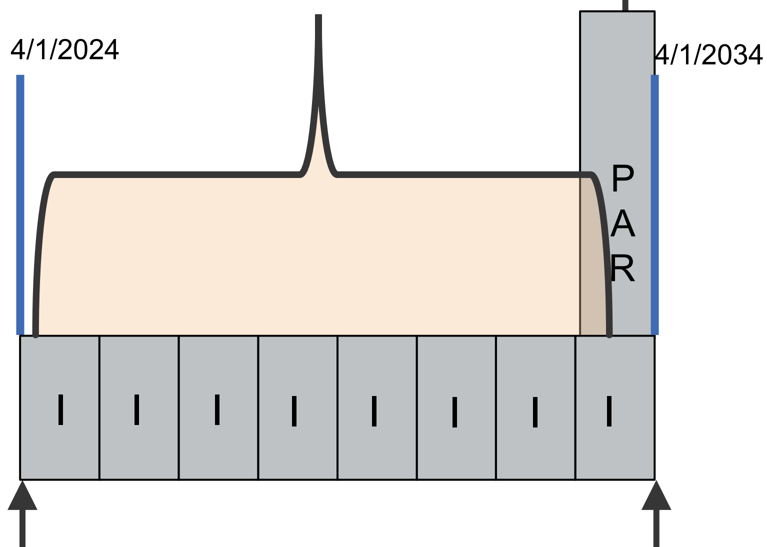
Setting the table: Advance vs. Current Refundings



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.

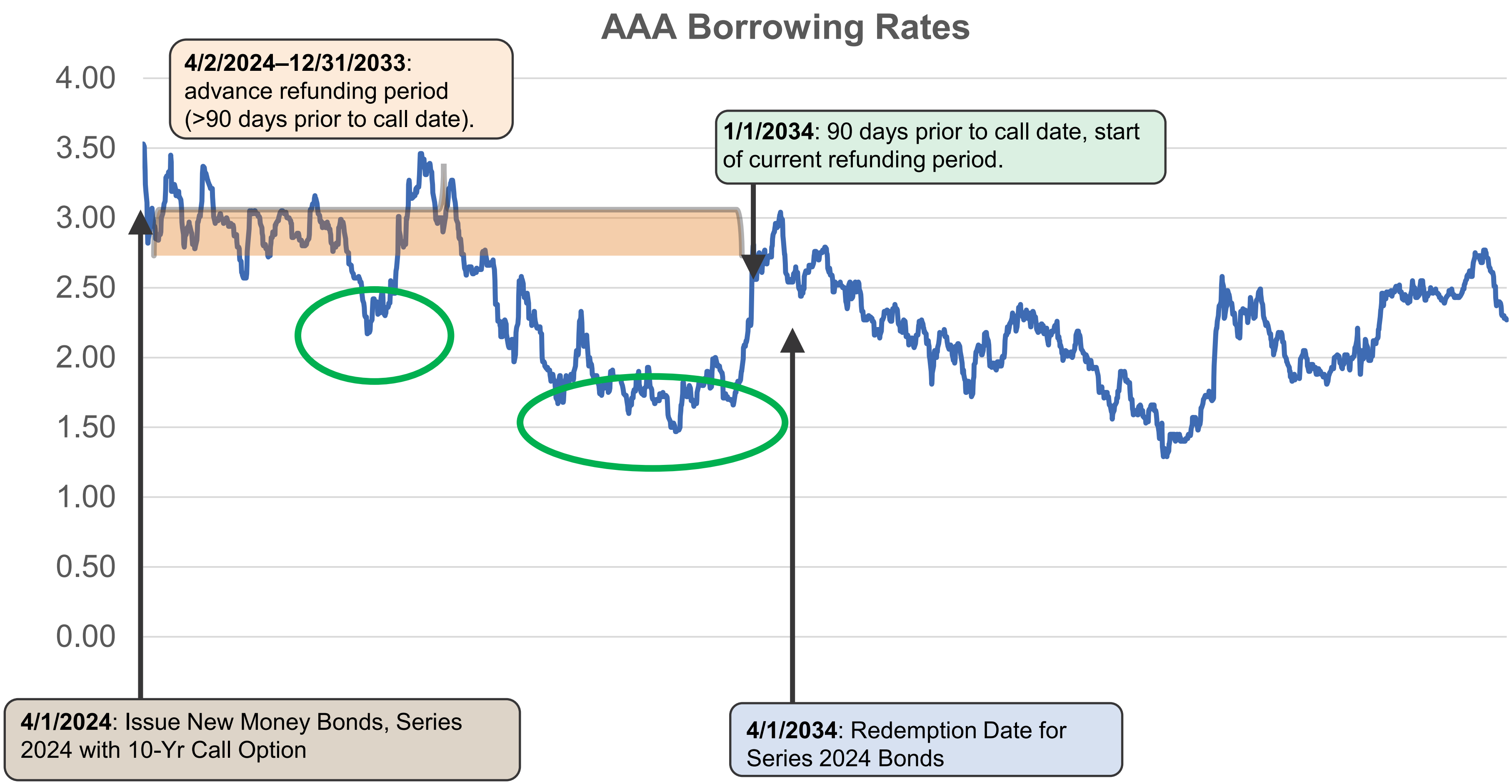
1/1/2034: **90 days prior to call date**, start of current refunding period.



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

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

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)

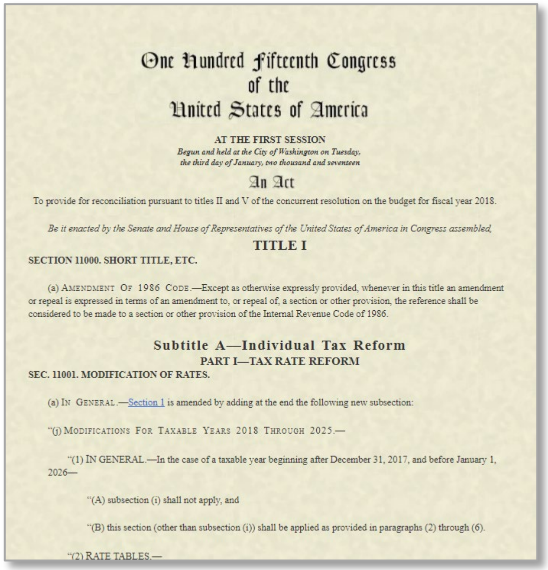
  d) Both of the above (a and b)

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:

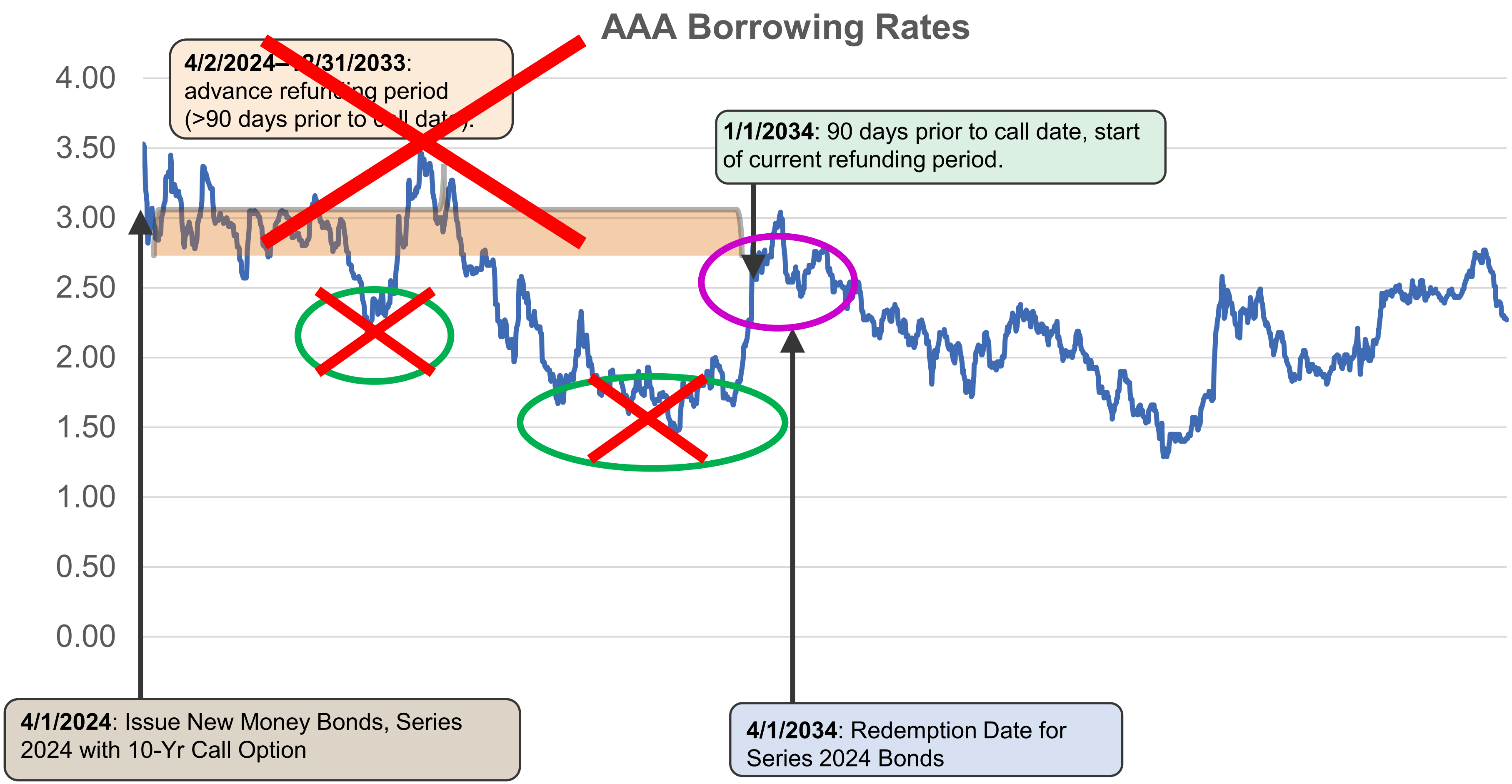
- Private activity bonds
- Stadium bonds

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

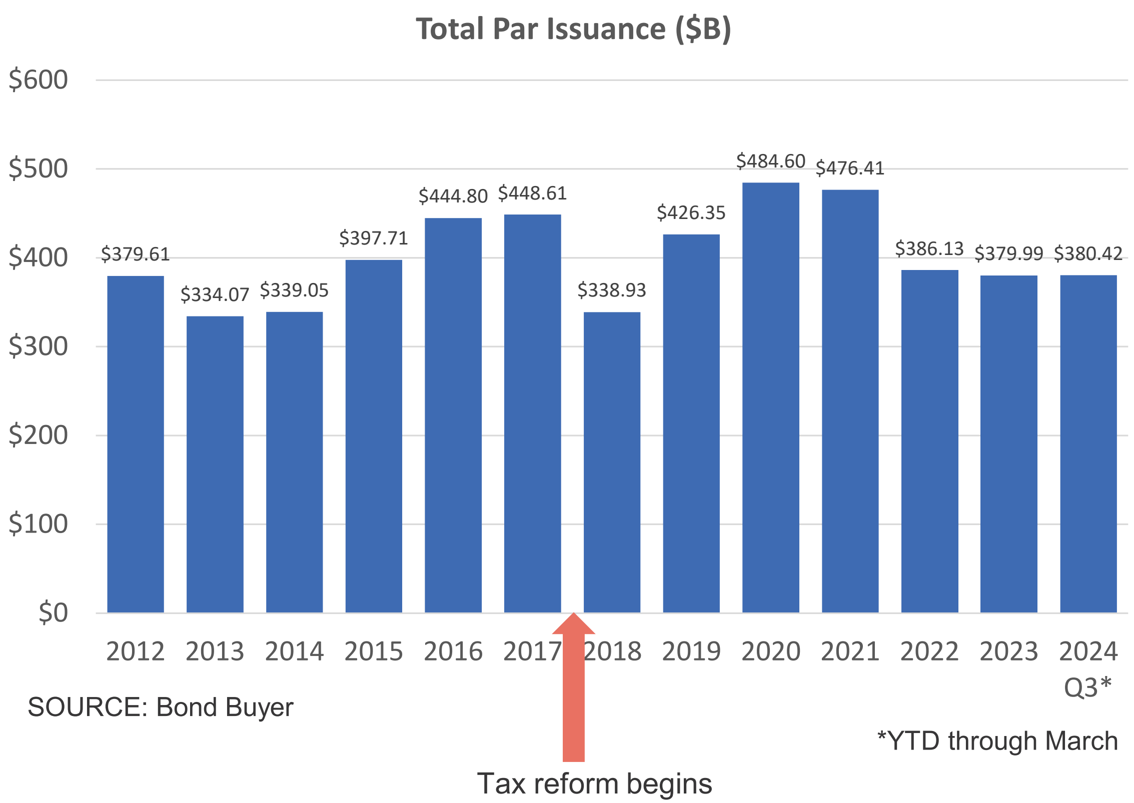


Poll question #2

- 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.
- 2024 has seen an uptick in volume, year to date, relative to recent years.



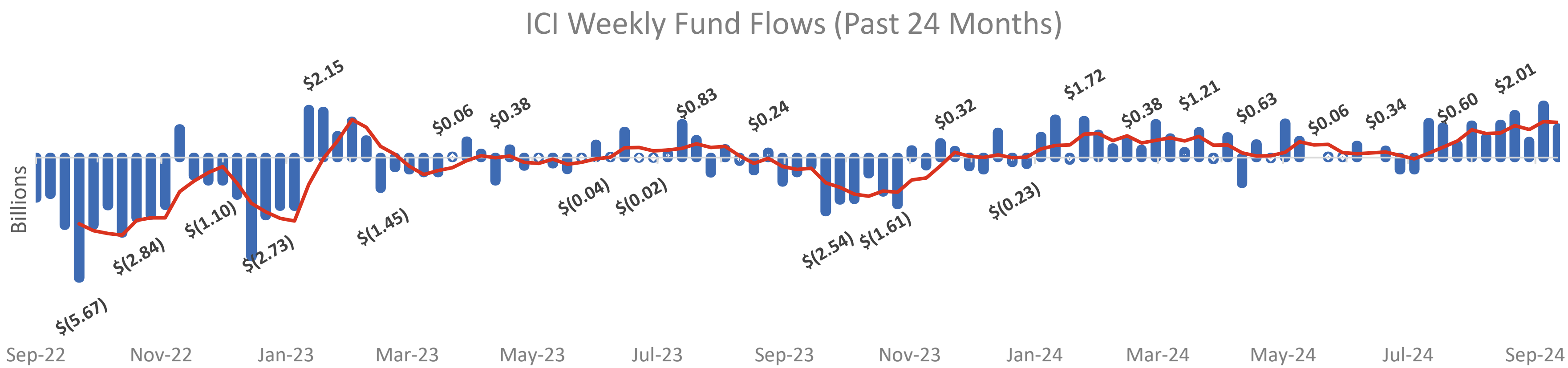
SOURCE: Bond Buyer

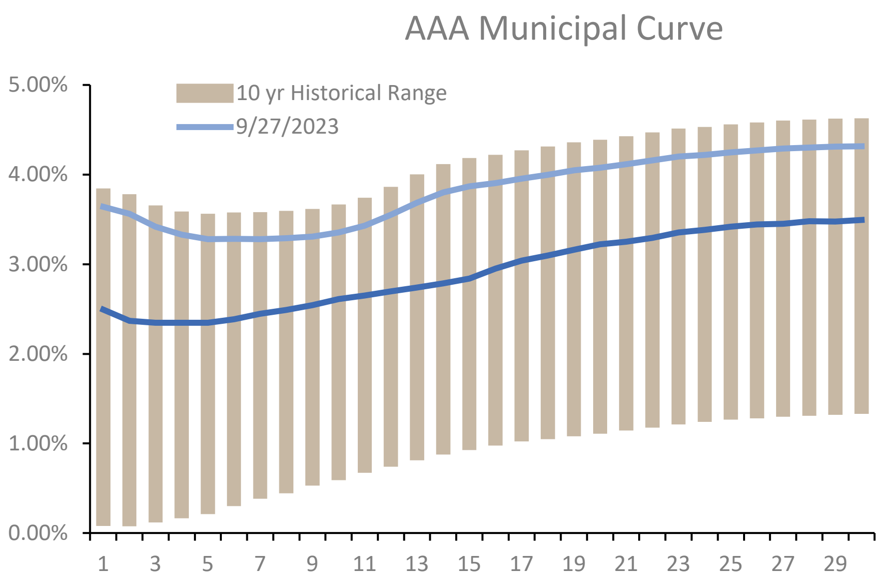
*YTD through March

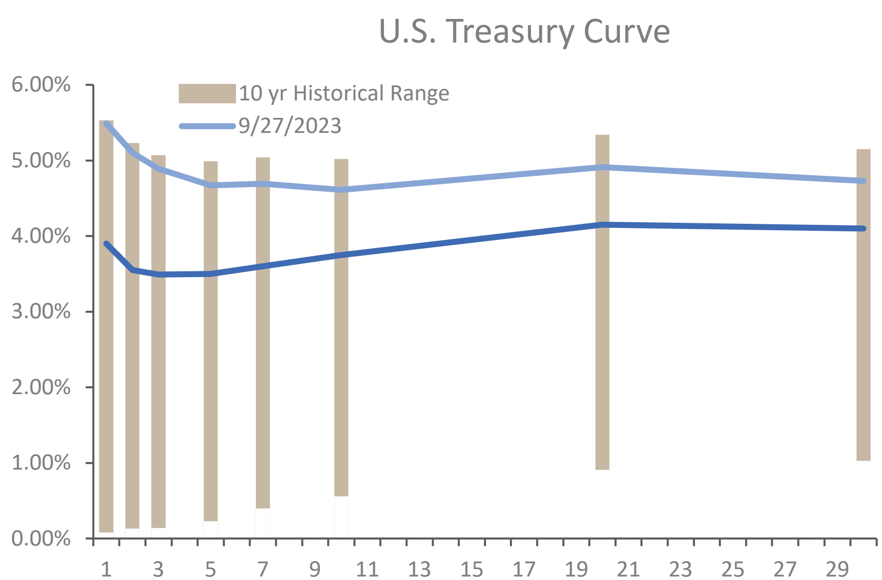
2024 Municipal Market Update – growing investor demand and increased volume

- 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 remained elevated through 2023.
- 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
- 2024 is been an improvement on 2022 and 2023, with strong demand for municipal bonds and lower rates driven by many factors, including FOMC rate cuts and expectations.
- Economic factors (e.g., inflation, potential for recession or a “soft landing”), FOMC activity, geopolitical events, investor demand, and the presidential election will continue to drive the market through 2024.

2024 Municipal Market Environment

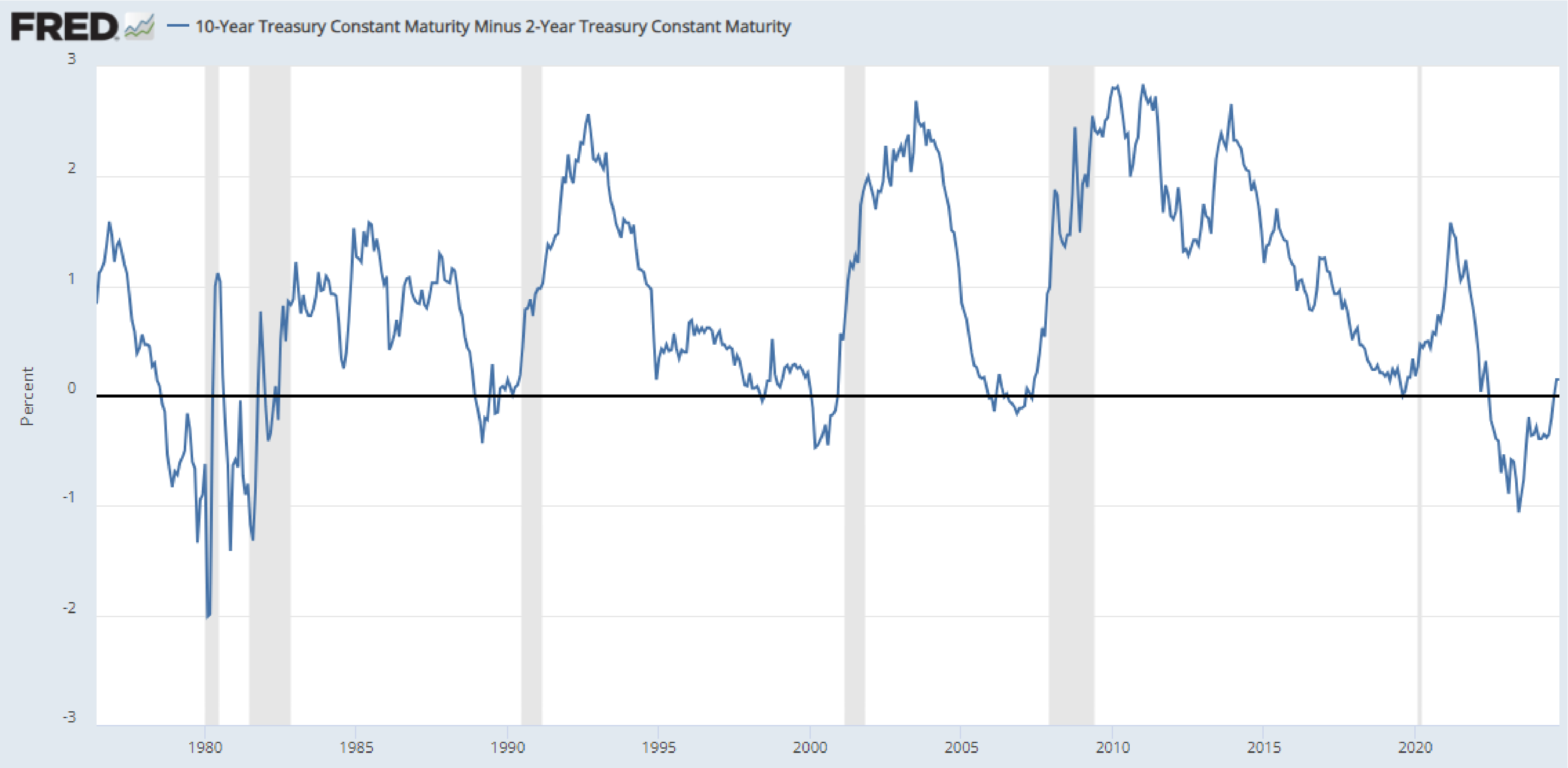






Source: Bloomberg

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) Inverted UST yield curves have historically led to periods of US economic expansion (i.e., GDP growth).
  c) The results of and events immediately following the 2024 presidential election could impact interest rates and the broader markets.

Tax-exempt advance refundings and the threat to tax-exemption

- Depending on the results of the upcoming elections, numerous legislative initiatives could have a serious impact on the municipal market and municipal bond issuers.
  - These impacts include both the potential restoration of tax-exempt advance refundings as well as an existential threat to municipal tax-exemption.
- It is important that we all continue to remind the public and lawmakers of the importance of tax-exemption and the benefits of tax-exempt advance refundings.

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