Tax Reform: Municipal Market Update & Considerations

Fundamentals of Public Finance Seminar

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April 30, 2025

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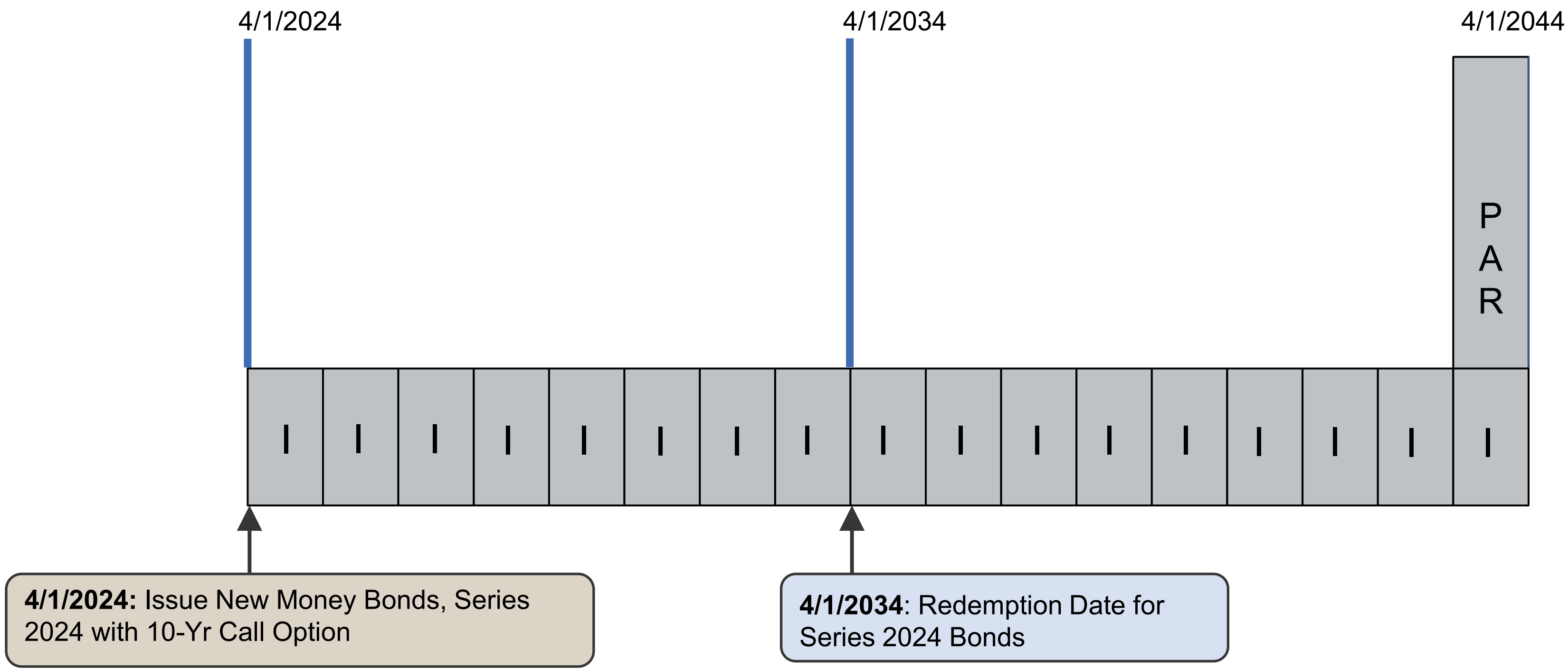
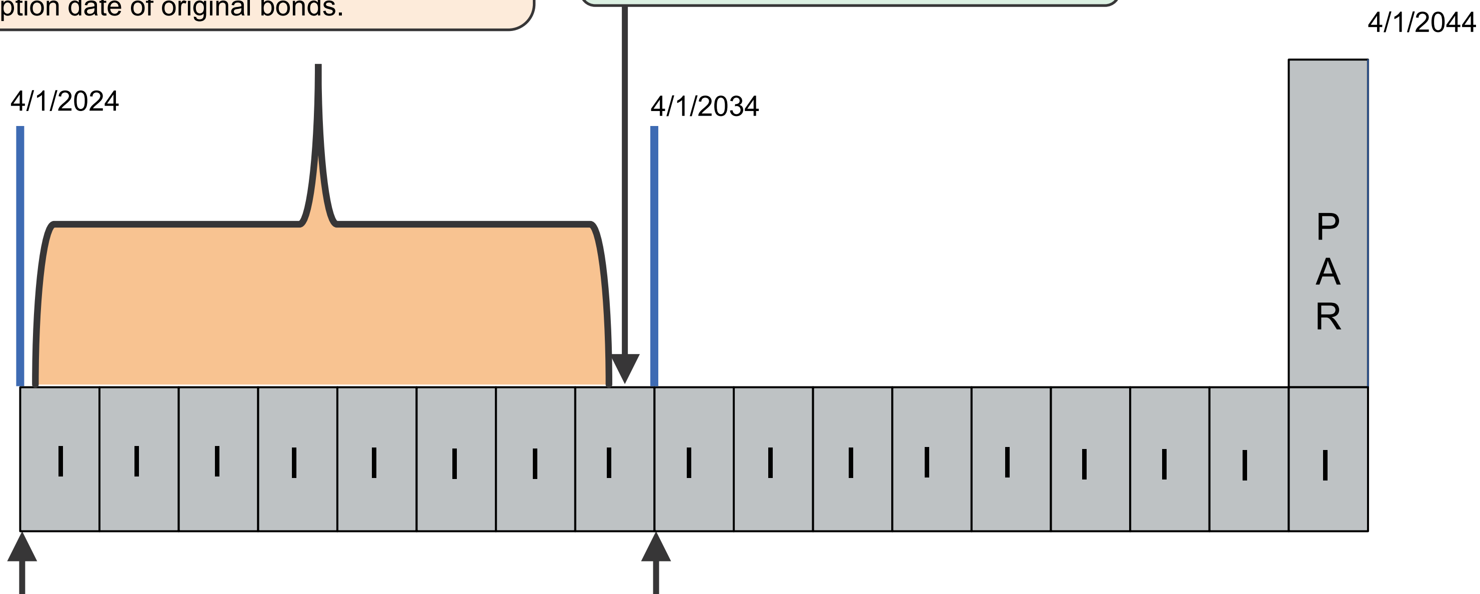
Setting the table: Advance vs. Current Refundings



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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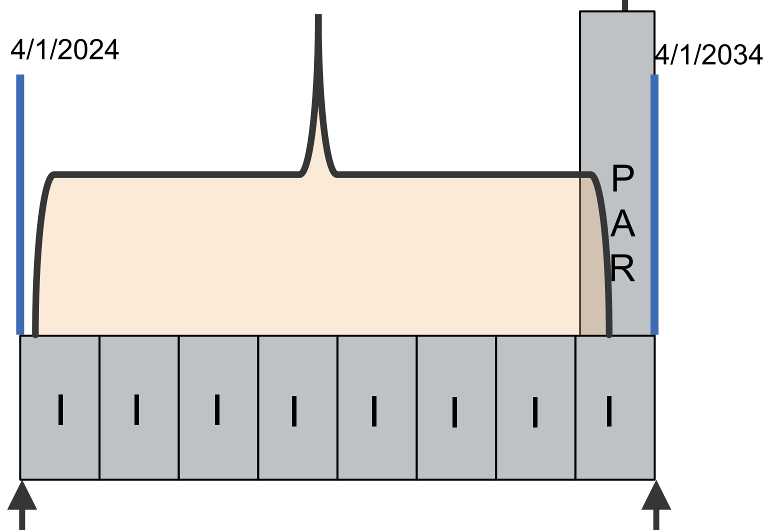
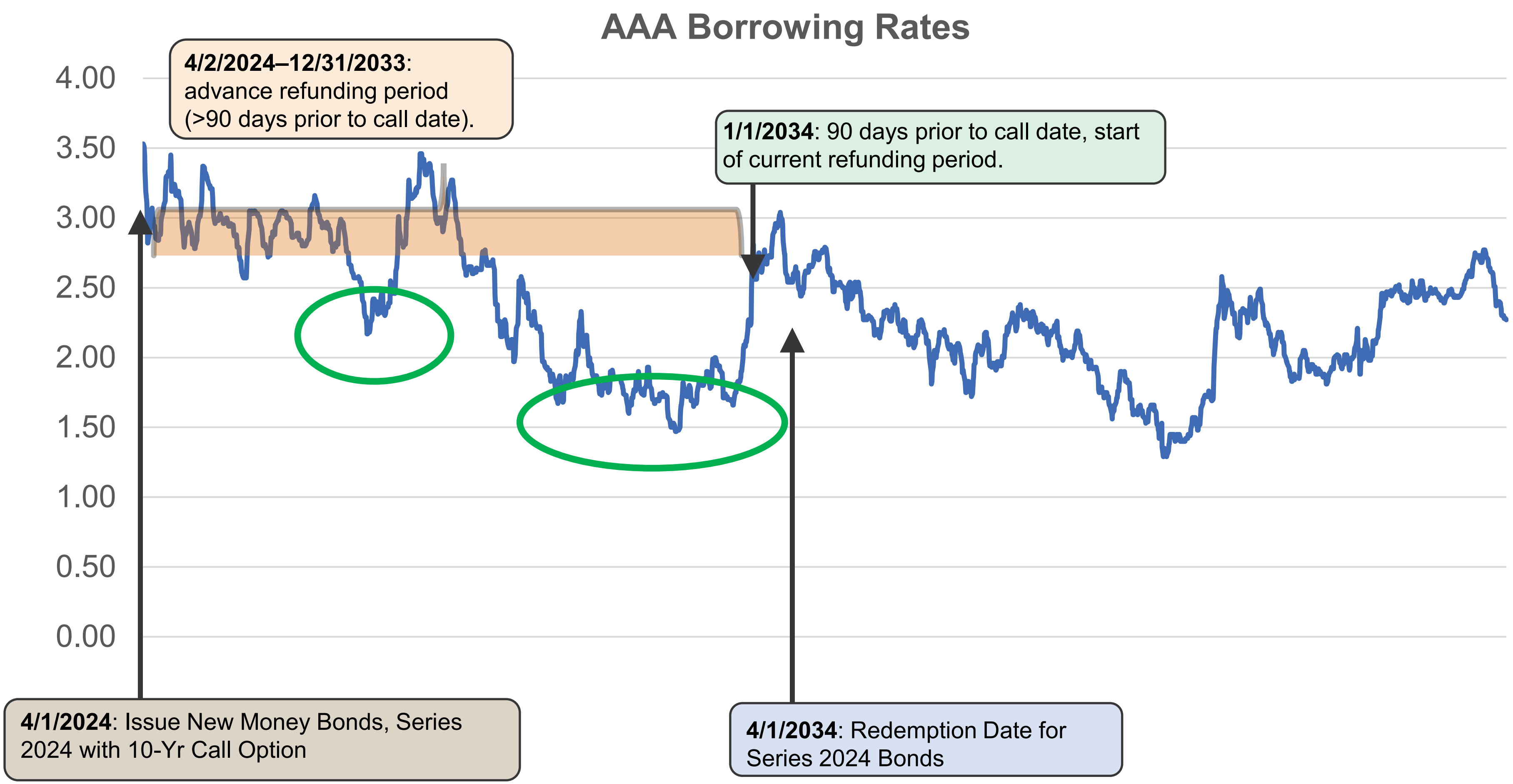


4/1/2024: Issue New Money Bonds, Series 2024 with 10-Yr Call Option

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

Advance refunding = flexibility + opportunity



For illustrative purposes only

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)

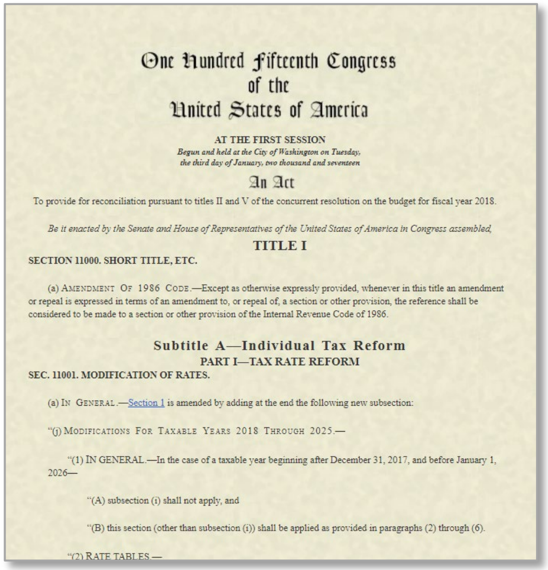
  d) Both of the above (a and b)

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:

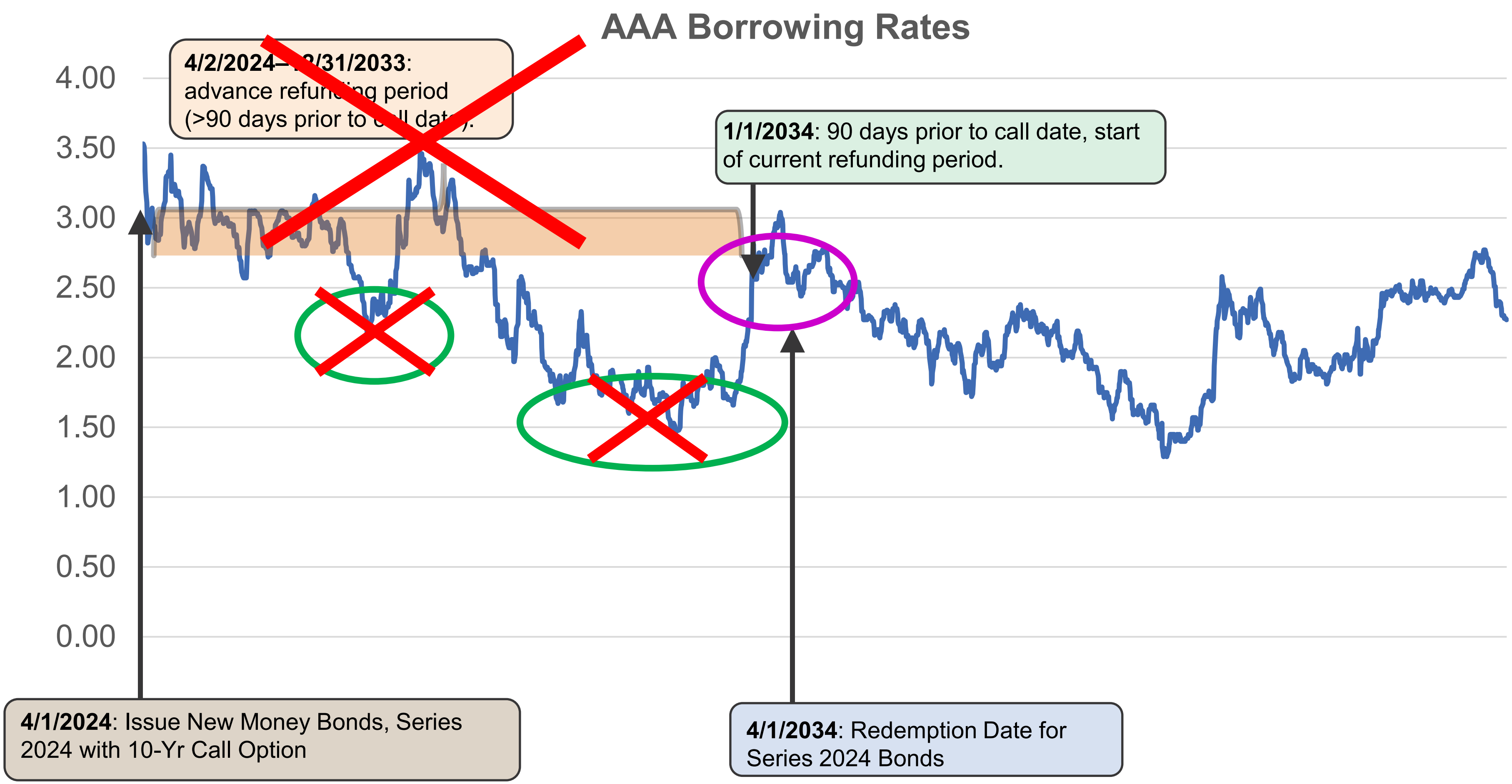
- Private activity bonds
- Stadium bonds

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

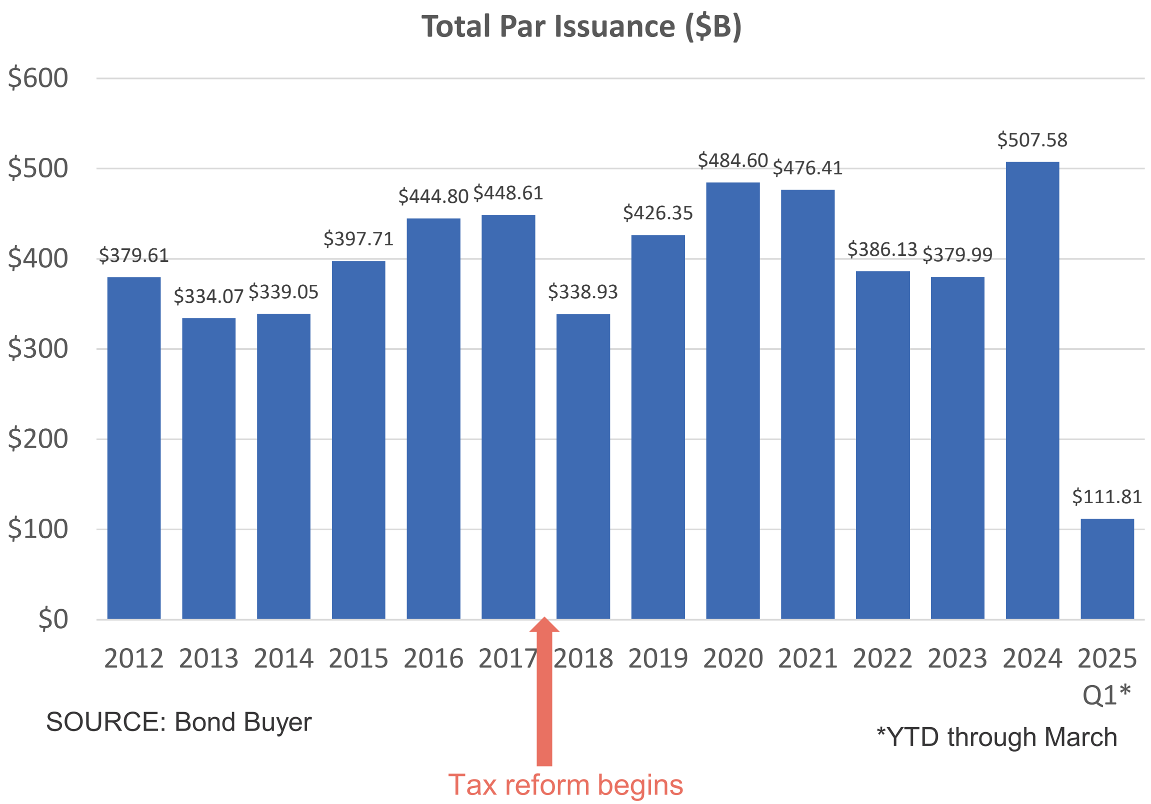


Poll question #2

- 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 – 2025: 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 volume increased significantly relative to recent years, and Q1 2025 is on a similar, if not higher pace.



SOURCE: Bond Buyer

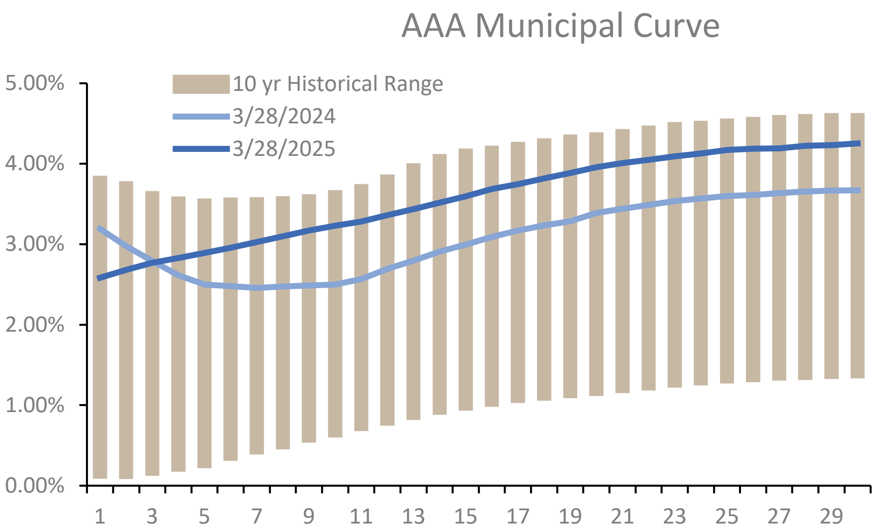
*YTD through March

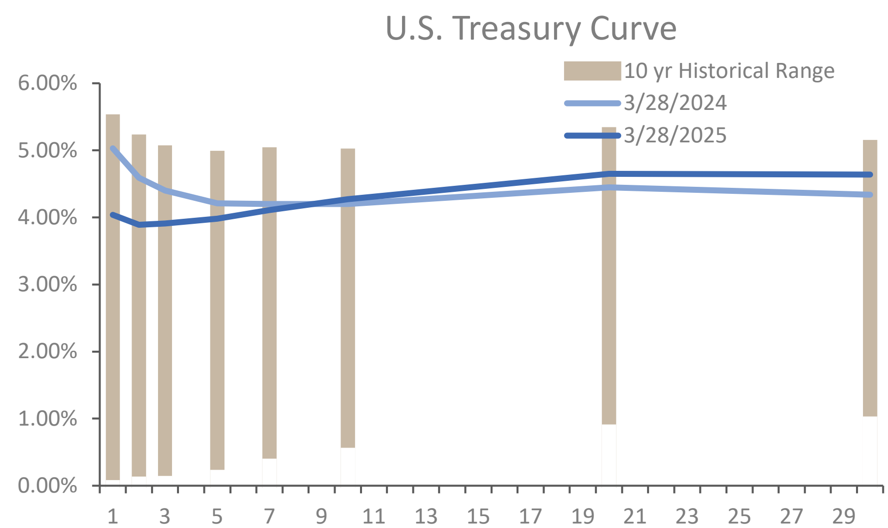
2025 Municipal Market Update – growing investor demand and increased volume

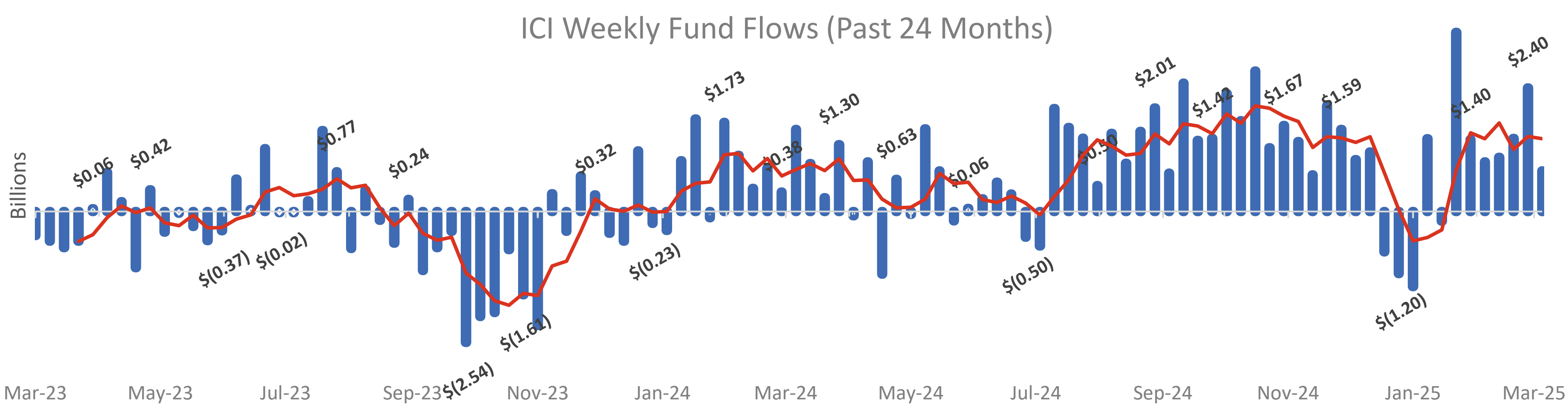
- Following the strong issuance environment and robust issuance volume throughout the COVID-19 pandemic, largely driven by historic low rates and federal stimulus packages, rates increased sharply beginning in January of 2022 and remained elevated through 2023.
- Increases in rates and volatility in the markets were largely due to:
  - Increases in inflation levels and ongoing challenges to reverse the trend
  - FOMC rate increases
  - Geo-political events
- 2024 saw significant improvement on 2022 and 2023 markets, with strong demand for municipal bonds and lower rates driven by many factors, including FOMC rate cuts and expectations.
- 2024 bond issuance volume rebounded, with 33% more par issued than 2023 issuance levels[1].
- 2025 issuance volume continues at a similar, if not more robust pace through the first quarter, despite ongoing interest rate volatility in US Treasury and municipal markets.
  - Economic factors (e.g., inflation, recessionary risks), FOMC activity, geopolitical events, investor demand, and ***US Congressional activity (e.g., tax reform)*** will continue to drive the market through 2025.

1. Source: Bond Buyer, Ipreo

2025 Municipal Market Environment

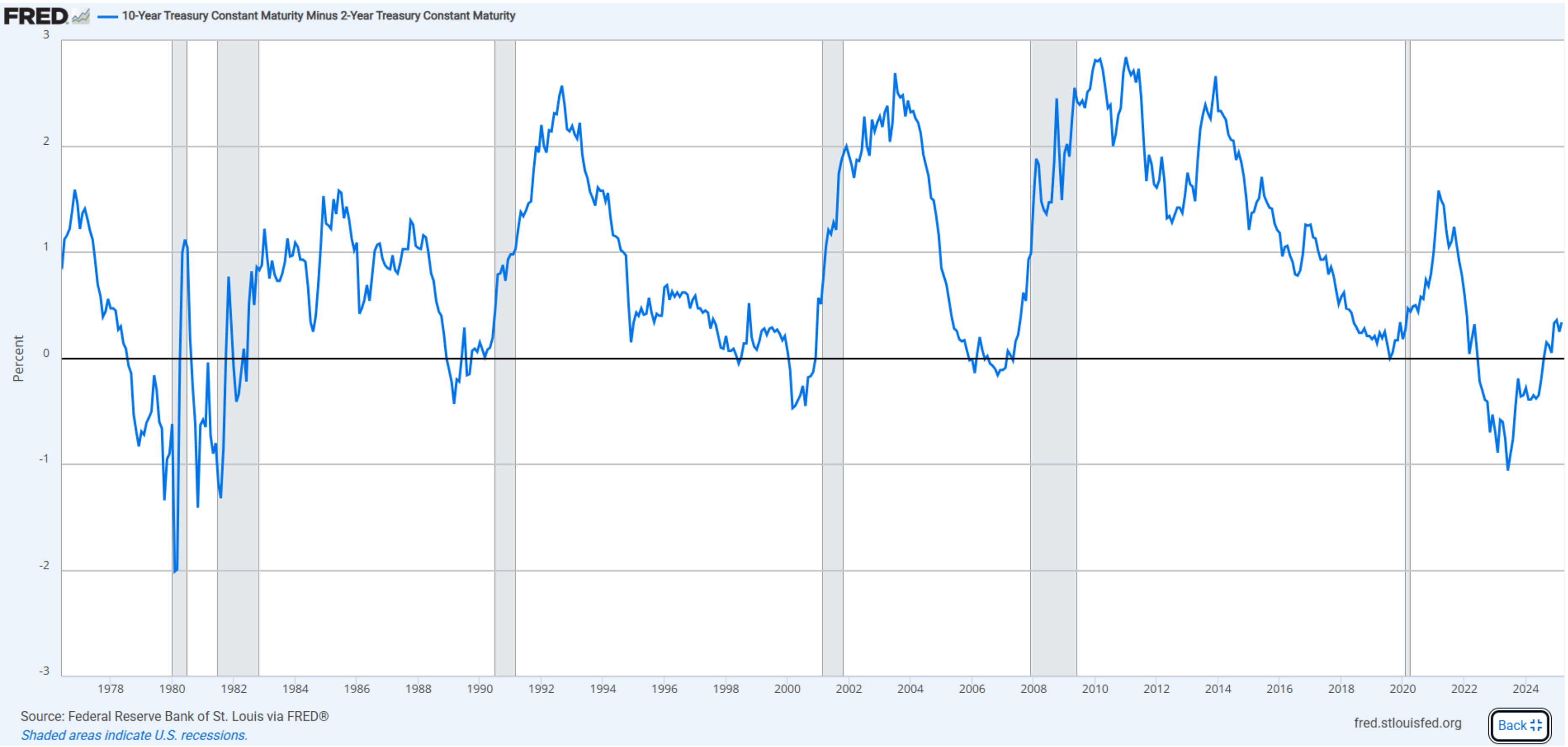






Source: Bloomberg

Where will the Fed go? Recessionary risks.



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 2025 market to date is characterized by high issuance volume and rate volatility.

The threat to municipal tax-exemption

- The new presidential administration and its congressional counterparts have stated their intent to extend and expand the tax reform and cuts first initiated in the 2017 Tax Cuts and Jobs Act ("TCJA")[1].
- Per the Congressional Budget Office, TCJA extension is expected to cost in the range of $4.0 trillion over the next ten years[2]. Expansion of TCJA into other areas could increase that figure substantially.
- Congress must find ways to offset decreases in revenues by cutting spending within the federal budget.
- **Amongst many other identified areas for spending cuts, full elimination of municipal tax exemption has been listed as a potential source of funding for TCJA.**
- Interested parties, organizations, and issuers across the US have mobilized to defend the preservation of municipal tax exemption, but the result remains unknown, and will not be resolved until the final deliberations of the federal budget and TCJA.
  - Should municipal tax exemption be left in place, there remains risks to other areas of our industry, such as private activity bonds and stadium bonds.
- What can you do? Have a voice → be in contact with your local Representatives and Senators to ensure that they are familiar with the importance of municipal tax exemption and its critical role in the affordable and efficient funding of infrastructure across the US.

1. Source: Congressional Budget Office, various news sources.
2. Source: Congressional Budget Office.

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