

U.S. Municipal Bond Market

Not an Immediate Threat to Tax-Exempt Status, Funding for Higher-Ed, or Other Municipals Despite President's Tweet; We Continue to Expect D.C. Support

Summary

- Over the last decade, we have seen various threats to the municipal bond tax-exemption.
- Today, President Trump tweeted that higher education tax-exempt status and funding could be “taken away.”
- If anything, we have been seeing and are expecting to see more support from D.C. lawmakers for elements directly related to COVID-19 aid and to the tax-exemption tax-expenditure in the near-term.

Recent History of the Threat to the Municipal Bond Tax-Exemption

Over the last decade, the tax-exempt status of municipal bonds has experienced different types of threats. Deficit reduction efforts were a key hazard just after the 2008 World Financial Crisis. In 2010, the Bowles-Simpson bipartisan deficit reduction plan recommended the elimination of the tax-exemption tax-expenditure. Federal spending line items, such as the tax-exemption, were being prioritized and considered leading up to the January 2013 Fiscal Cliff.

Finally, at the end of 2017 we observed the most severe threat of the last decade when the tax-exemption for private activity bonds, which includes public and private higher education, was officially put on the chopping block as lawmakers considered how to pay for the Tax Cuts and Jobs Act of 2017. At the end of the day, the tax-exemption for private activity bonds was kept, although the use of the tax-exemption for advance refundings was eliminated to help offset the cost of the 2017 tax cut.

We are Seeing the Potential for Washington, D.C. Support for State, Local Governments, & Municipals

Since the beginning of June, we began to see a consensus build for another round of COVID-19 relief for state and local governments. In the middle of June, House Democrats also proposed and then the House passed a \$1.5 trillion Moving Forward Act that includes several municipal bond-friendly elements. One of those elements, for example, would reinstate the use of the tax-exemption for advance refundings.¹ In other words, we do not currently see a threat to the general tax-exemption. If anything, we see opinion moving in favor of allowing more options for state and local governments and other municipal entities, including higher education institutions.

Re-Examine Tax-Exempt Status, Funding of Higher-Education

During the morning of July 10, 2020, President Donald Trump tweeted:

“Too many Universities and School Systems are about Radical Left Indoctrination, not Education. Therefore, I am telling the Treasury Department to re-examine their Tax-Exempt Status...and/or Funding, which will be taken away if this Propaganda or Act Against Public Policy continues. Our children must be Educated, not Indoctrinated.”²

Please see disclosure starting on page 3.

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If anything, we have been seeing and are expecting to see more support from D.C. lawmakers for elements directly related to COVID-19 aid and to the tax-exemption tax-expenditure in the near-term.

Now, we are not certain if there is a broader context or reason for the President to tweet this. This week he also made a similar warning to school districts.³ Currently, we are not aware of a larger context, or of an actual threat to the tax-exempt status, funding of state and local governments, or private activity bonds, including public and private higher education institutions. We are not certain why the President, at a time when higher education institutions are on the front line in trying to contain the spread of COVID-19 along with other public sector entities, would tweet such a warning.

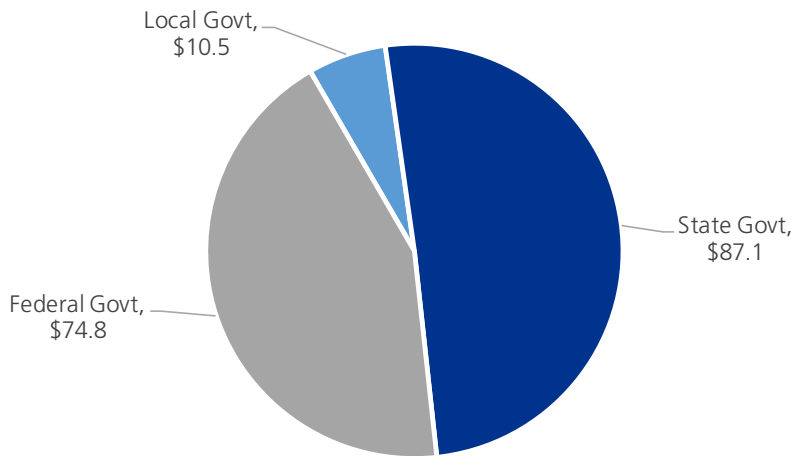
If anything, as we noted above, we have been seeing and are expecting to see more support from Washington, D.C. lawmakers for elements directly related to COVID-19 aid and to the tax-exemption tax-expenditure in the near-term.⁴

Higher Education Funding

The President alone does not control federal higher education spending. By and large Congress controls the overall spending decisions. However, we should note the White House in the last several years has sought cuts to education spending. In 2019, the White House again proposed to lower student aid, which Congress rejected.⁵

The majority of federal funds for higher education are for Pell grants and other financial aid and funding. There is about \$172 billion of government funding for higher education that comes from the federal, state, and local level.⁶ In past decades, the federal government made up a larger percentage than it does now but the federal government began to reduce higher education funding.⁷

Federal Government Contributes \$75 Billion (43%) of Higher-Ed Government Spending (\$ in billions)



Source: Pew Trusts and HilltopSecurities.

Now, state government contributions make up the largest amount of government higher-ed funding. For the 2017 academic year, state government funding was \$87 billion (51%), federal government funding was \$75 billion (43%), and local government funding made up only about \$10 billion (6%) of government funding for higher education.⁸ We should also note that state funding for higher education has fallen in the last decade, as highlighted in this report by the Center on Budget and Policy Priorities: [State Higher Education Funding Cuts Have Pushed Costs to Students, Worsened Inequality](#), Oct 24, 2019.

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¹ Please see: Kozlik, Tom; [\\$1.5T for Infrastructure in Proposed "Moving Forward" Act, Municipal Friendly Elements Included](#); HilltopSecurities; July 10, 2020.

² Donald J. Trump, @realDonaldTrump. Twitter Post. July 10, 2020, 10:49 AM. <https://twitter.com/realDonaldTrump/status/1281616586273468416>

³ Kozlik, Tom; [President Cannot Cut Public School Funding; Schools, State and Local Governments Likely to See Aid in July/August; Jobless Claims Remain Elevated, at Risk; National MEI Index falling Again](#); HilltopSecurities; July 10, 2020.

⁴ We reiterated our expectation for aid on page 3 of *ibid*.

⁵ Kreighbaum; [Trump Seeks Billions in Cuts](#); InsideHigherEd; March 12, 2019.

⁶ [Two Decades of Change in Federal and State Higher Education Funding](#); Pew Trusts; October 15, 2019.

⁷ See more on this in *ibid*.

⁸ [Two Decades of Change in Federal and State Higher Education Funding](#); Pew Trusts; October 15, 2019.

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