

U.S. Municipal Bond Market

Threat Now Imminent, Advocacy for Infrastructure Financing Tool Falling Way Behind in Tempo

- **Imminent Threat to Municipal Bond Tax-Exemption:** The House Committee on Ways and Means is considering a full repeal of tax-exempt interest for municipal bonds.
- **Urgent Call for Advocacy:** Public entities and state and local leaders have a limited window in January and February 2025 to advocate for the preservation of the municipal bond tax-exemption. The report emphasizes that education and advocacy efforts are currently way behind in tempo compared to the legislative process.
- **Significant Financial Impact:** Eliminating the municipal bond tax-exemption could raise borrowing costs by \$824 billion over the next ten years, translating to an additional financial burden of approximately \$6,554.67 per American household. This change would hinder the ability of state and local governments to fund critical infrastructure projects, impacting public services and economic growth.

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A Final Call to Action for Public Entities, Public Sector Leaders

The municipal bond tax-exemption now faces an imminent threat, demanding urgent action.

The House Committee on Ways and Means revealed a list of potential pay-fors last week. The list includes a combination of policy priorities and repeals contemplating the elimination of many federal tax-expenditures. Notably, a full repeal of tax-exempt interest for municipal bonds, Private Activity Bonds (PABs), Build America Bonds (BABs), and other non-municipal bonds is included on page nine of the 50-page document.

Public entities and state and local leaders have a limited window in January and February 2025 to advocate for the preservation of the municipal bond tax-exemption.

This proposal likely has a solid foundation. In April last year, Ways & Means Chairman Jason Smith and Tax Subcommittee Chairman Mike Kelly formulated and announced tax teams to identify and prioritize legislative priorities.

The remaining weeks of January and February 2025 may represent the final opportunity for public entities and state and local leaders to advocate for the crucial financing mechanism that supports America's infrastructure.

Our Warnings Seem to be Falling on Deaf Ears

We fear our numerous warnings are continuing to fall on deaf ears. An initial signal of a lack of support for public entities came when lawmakers did not include bond financing-friendly elements in the \$1.2 trillion Infrastructure Investment and Jobs Act of 2021 or in the trillions of other fiscal policies enacted in 2020, 2021 and 2022. Additionally, the specific warnings we issued date back to the end of the summer of 2022.

- We indicated, “Washington could target the tax exemption,” in a collaboration titled The Next Big Risk we published back on Sept. 8, 2022. We summarized our warning by writing, “It is important that state and local government related organizations, public finance industry groups, and related parties increase the amount of education currently being done in Washington to inform lawmakers about the policy implications of different scenarios related to the municipal bond tax-exemption” (see page 10).
- We published a call to action for public entities and public finance back in August 2023, just after Fitch Ratings downgraded the U.S. sovereign rating. Please see Save the Tax-Exemption, A Call to Action for U.S. Public Finance (August 17, 2023).
- Just after the November 2024 elections we wrote, An Almost Imminent Threat to the Municipal Bond Tax-Exemption is Here: Act Now to Preserve This Vital Infrastructure Financing Tool (Nov. 13, 2024).
- We even included the potential elimination as part of the base case in our municipal bond issuance forecast for 2025, published on Nov. 25, 2024.
- Then at the beginning of January, as the political support for raising the SALT cap grew, we wrote Growing Support for SALT Cap Expansion, Backing for Tax-Exemption Needed (Jan. 9, 2025).

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Education and Advocacy Efforts are Behind in Tempo

A compelling bipartisan argument can be made in support of the municipal bond tax-exemption. This exemption is a critical tool for financing a significant portion of U.S. infrastructure projects, including roads, bridges, schools, and hospitals. Eliminating the municipal bond tax-exemption would not only increase borrowing costs for state and local governments but also widen the infrastructure gap, hindering essential development and maintenance efforts. Preserving this tax-exemption is vital for sustaining and advancing the nation's infrastructure, ensuring that public entities can continue to meet the needs of their communities effectively.

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Eliminating the municipal bond tax-exemption would have significant financial repercussions. This policy change would raise borrowing costs by \$824 billion over the next ten years according to the Government Finance Officer's Association's Public Finance Network (see page 2). This increase in costs could translate to an additional financial burden on every American household, amounting to approximately \$6,554.67 over the next decade. Such a move would not only strain public finances but also hinder the ability of state and local governments to fund critical infrastructure projects, ultimately impacting the quality of public services and economic growth.

Overall, we still think there is a 50% or greater chance that the municipal bond tax-exemption could be eliminated or significantly curtailed. The chances of this would drop significantly if we were aware of a concerted advocacy and education effort in support of the tax exemption, similar to like what has been occurring in support of raising the SALT cap. But, advocacy and education efforts in support of the tax exemption are behind in tempo to the policy making process that will likely end up as The America First Tax Cuts Act of 2025.

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Behind in tempo means the efforts to advocate for and educate about the importance of the municipal bond tax-exemption are not progressing as quickly as the legislative process. As a result, there is now an imminent risk that the tax-exemption could be eliminated or significantly curtailed.

Many who understand the importance and value of the municipal bond tax-exemption to state and local governments may overestimate the likelihood that the rest of Washington, D.C., will prioritize it over other policy initiatives. Supporters of the tax exemption, including state and local lawmakers and public entities, must clearly communicate its significance and emphasize its importance to ensure D.C. lawmakers fully understand its value. Without this connection, Washington policymakers could become fixated on numbers on a chart and overlook the real-world consequences of its decisions. This sentiment echoes the concerns expressed by Chris Iacovella, CEO of the American Securities Association, in his recent publication, "[The \\$823 Billion Tax Bomb Threatening America's Communities](#)" (Jan. 21, 2025).

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Seizing Advantageous Entry Points Amid the Potential Tax-Exempt Status Change

Generationally attractive tax-exempt yields continue to be a key feature of the predominantly tax-exempt municipal bond market. Our base case projects \$745 billion in municipal bond issuance for 2025. We anticipate a significant increase in issuance activity over the last nine months of the year due to the potential elimination. This scenario could offer some of the most advantageous entry points for tax-exempt bonds in 2025, as the market may struggle to absorb approximately \$50 billion to \$80 billion of new issuance a month for nine or more straight months.

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Recent HilltopSecurities Municipal Commentary

- [Growing Support for SALT Cap Expansion, Backing for Tax-Exemption Needed](#), Jan. 9, 2025
- [Building America's Infrastructure with Municipal Bonds: A 2024 Overview](#), Dec. 23, 2024
- [Forecasting \\$745 Billion in Municipal Bond Issuance for 2025 Amid Potential Tax-Exemption Elimination](#), Nov. 24, 2024
- [Crypto Abstinence: Safeguarding Public Entity Credit Quality, Taxpayer and Public Funds by Avoiding Digital Illusions](#), Nov. 20, 2024

Readers may view all of the HilltopSecurities Municipal Commentary [here](#).

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