

U.S. Municipal High Yield Market

## Advocacy and Education are Critical to Thwart the Potential Loss of the Municipal Tax Exemption

The potential loss of the federal tax exemption is a significant concern to the issuing community that is providing essential services. It will increase their cost of capital and can negatively affect national infrastructure. The current situation reflects three key themes: Fiscal Stewardship, Political Landscape, and Advocacy.

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### Fiscal Stewardship

The 2017 Tax Cuts and Jobs Act (TCJA), which introduced important individual and business tax cuts, is set to expire at the end of 2025. While the Treasury Department projects that the extension of TCJA is projected to cost \$4.2 trillion between 2026 and 2035, the Committee for a Responsible Federal Budget estimates that extending these provisions could create a \$5 trillion cost. If the TCJA is to be extended, cost-saving initiatives will be necessary to control the federal deficit.

### Political Perspective

The Trump Administration has shown a willingness to challenge convention to meet its priorities. Some of these mandates, including the doubling of the State and Local Tax (SALT) cap and the elimination of taxes on tips, could have significant fiscal implications to state and local governments as well as the federal government. In fact, the Committee for a Responsible Federal Budget projects the SALT initiative could add an additional \$170 billion and the tip exemption could add over \$100 billion to the federal deficit over the next decade (on top of the \$4.2 - \$5 trillion number previously quoted) which will need to be accommodated in long term budget planning.

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It is within this fiscal and political context, on January 17, the House Ways and Means Committee released a 51-page list of targeted programs which includes the consideration of the full repeal of the tax exemption on municipal bonds.

The repeal of the municipal tax exemption is estimated to generate approximately \$500 billion in savings over 10 years – approximately 75% derived from municipal and state exemptions and about 25% from private activity bond allocations. However, this repeal is not without significant cost. The Government Finance Officers Association (GFOA) and other academic organizations argue that this cut is short-sighted. They suggest that borrowing costs for local governments and other currently tax-exempt entities could increase by 25% to 40% if the tax exemption is lost. Ironically, smaller, more fiscally challenged, and less sophisticated entities will most likely be hit hardest by the higher costs and potential limiting capital market access, thereby leading to an estimated interest rate increase of approximately \$850 billion over the same time period. As a result, there would not be a cost savings, but a projected \$350 billion cost increase!

## Advocacy Perspective

Governors and mayors are focused on prioritizing their constituents' concerns on the economy, public safety, immigration, as well as affordable housing and recent environmental and infrastructure disasters have exacerbated these issues.

The question of tax exemption does not appear on their radar screens. However, Washington needs the backing of elected officials to address the preservation of tax exemption to fund critical infrastructure and government.

Elected officials must recognize that eliminating the municipal tax exemption will raise borrowing costs by 25% to 40%, directly affecting their ability to provide essential infrastructure including safe drinking water, roads, bridges, schools, public safety facilities, and public health buildings, most of which require improvements.

This is a significant concern for Main Street, not Wall Street as it will increase their cost of services and limit the ability to finance projects at the state and local level thereby affecting their quality of life. This will cost taxpayers an estimated \$350 billion over ten years and will not generate a net savings. Only when our elected representatives understand the true costs and benefits of the municipal tax exemption and communicate these issues to their legislative representative, will there be a chance to preserve this vital tool.

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