

TAX CUTS AND JOBS ACT

First draft of tax reform bill eliminates private activity bonds and advance refundings.

*On Thursday, November 2, 2017, Republican members of the U.S. House Committee on Ways and Means rolled out a 429-page bill called **The Tax Cuts and Jobs Act. H.R.1, as introduced**, is just the first step in a series that may lead to major tax reform for the first time in 30 years. Now that specific language is available, groups with special interests have engaged. The hallways outside the Committee room are once again known as “Gucci Gulch” for all the well-heeled lobbyists seeking time with members.*

HJ Sims has concerns with two sections that we view as harmful to our communities and to our clients who are not represented by high-priced lobbyists. These provisions affect a good percentage of total municipal bond issuance, and are likely to produce some unexpected volatility in the municipal market in the coming weeks:

- *The proposed elimination of private activity bonds, and*
- *The proposed elimination of advance refundings.*

We strongly oppose the elimination of private activity bonds.

Section 3601 of the House bill as introduced would make several amendments to the Internal Revenue Code for the purpose of eliminating the authority of state and local governments to issue Private Activity Bonds (PABs) as of January 1, 2018. The Joint Committee on Taxation projects that this will produce a \$38.9 billion revenue increase over the 2018-2027 period.

- *This proposal would eliminate the federal tax exemption for interest earned on all private activity bonds – including 501(c)(3) bonds and exempt facility bonds – issued after December 31, 2017. It would impose significant new borrowing costs on entities such as nonprofit hospitals, life care communities, nursing facilities, charter schools, universities, research institutions, affordable housing, and similar borrowers. Such borrowings represent a significant percentage of the municipal bond market and there are major ramifications to imposing such dramatic change so quickly. Our elected officials need to be informed of the impacts that this change would have on essential community purpose projects, services, and jobs.*
- *Specifically, this section would strike from the Internal Revenue Code Sections 142 (Exempt Facility Bonds), 143 (Qualified Mortgage Bonds and Qualified Veterans’ Mortgage Bonds), 144 (Qualified Small Issue Bonds, Qualified Student Loan Bonds and Qualified Redevelopment Bonds), and 145 (501(c)(3) Bonds), as well as Sections 146 and 147, which set forth operating rules for interest on private activity bonds, including 501(c)(3) bonds, to qualify for the exemption from federal income tax under Section 103 of the code. Section*

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103 encourages investment in state and local governments and non-governmental entities carrying out public projects such as charter schools and low-income housing projects by making it less costly for them to borrow funds. Nonprofit borrowers are already concerned about imminent Fed rate hikes, so these surprising new additional costs would be a double whammy.

- PABs are a staple of economic development efforts and an important financing tool for spurring private sector investment and job creation. They provide a reliable and affordable means of low-cost financing for thousands of projects across the country. The Council of Development Finance Agencies (CDFA) reminds us that PABs have been in existence since 1914 and are the traditional means of tax-exempt financing for certain critical infrastructure. Taxing interest on qualified private activity bonds, as proposed, may prevent many important assisted living, memory care, skilled nursing and other projects important to our aging seniors from being funded. The repeal of private activity bonds will also negatively affect the financing of many colleges, museums, research institutions, and other nonprofit organizations, as well as public-private partnerships used to finance public charter schools, government utilities, and the rehabilitation of blighted neighborhoods.
- A Bank of America Merrill Lynch analysis shows that California accounts for nearly 25% of all PAB issuance, followed by New York, Minnesota, Ohio, Texas, Washington state, Massachusetts, Michigan, Florida, Connecticut and New Jersey.
- Industry experts estimate that the interest rates for borrowers would increase by 1.5% to 2.5% if PABs are eliminated, and that translates to an increase of 25% to 35% in the cost of borrowing by state and local governments and the nonprofit borrowers on whose behalf they issue bonds. This would reduce the size of the municipal market by a significant degree.
- This section does not specify any transition rules for refundings. So counsel advises that it could prevent a tax-exempt refunding (or reissuance), after December 31, 2017, of any currently outstanding PABs issued under the general rules of the Tax Reform Act of 1986.
- Initial legal opinions indicate that this section appears to eliminate tax-exempt treatment of any rolls and bond take-outs of outstanding private activity commercial paper that occur after December 31, 2017 as well as the ability for a borrower of outstanding private activity bonds issued on a draw-down basis to take any additional draws after December 31, 2017. Borrowers may have to accelerate draws and draw all remaining committed funds, defeating the purpose of the draw-down structure; this could require our clients to incur a significant amount of additional interest expense.
- Although the House bill preserves the Low-Income Housing Tax Credit (LIHTC), its repeal of the PAB rules will eliminate the availability of credits for projects where at least 50% is financed by tax-exempt private activity bonds.
- If this proposal became law, very large issuers may be able to assemble financing teams and documents quickly to get in under the December 31 deadline, but smaller issuers could be penalized as they are less likely to mobilize in time to refinance or obtain new loans by the end of the year.

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- *There is a clear and convincing need for improvements to American infrastructure: airports, bridges, tunnels, docks and wharves, water and sewer treatment facilities, pollution control, multifamily housing and other projects. These facilities have been built and can be repaired or replaced with tax-exempt bonds. Now is not the time to make it more expensive for nonprofit organizations and public-private partnerships to finance capital projects.*

We strongly oppose elimination of advance refundings.

Section 3602 of H.R. 1 would amend the Internal Revenue Code to eliminate the ability of state and local governments to execute advance refundings of outstanding tax-exempt and 501(c)3 bonds. The Joint Committee on Taxation estimates a \$17.3 billion increase in revenue as a result of this repeal.

- *This proposal would remove an important tool for refinancing outstanding debt at lower interest rates. Refinancing lowers the cost of government and enables borrowers to use savings to improve debt service coverage, make facility improvements, and expand services.*
- *Advance refundings allow well managed state and local governments and qualified borrowers to respond to credit market conditions to reduce their interest costs. They have resulted in many billions of dollars of savings for states and localities.*
- *This year, advance refundings comprise approximately \$72 billion or 22% of year-to-date issuance.*
- *Advance refundings are highly regulated, and prohibiting them would result in billions of dollars of unnecessarily high borrowing costs for states and localities, and far less investment in infrastructure repair and replacement.*

The legislative process ahead.

This bill is on a fast track for passage before Thanksgiving. A limited number of changes approved by the House Ways and Means Committee Chairman and Republican majority will be incorporated as amendments during the Committee mark-up which begins November 6. The Committee-reported bill is expected to be taken up by the full House during the week of November 13, while a Senate version is crafted in the Senate Finance Committee. The House is expected to pass the bill with very few changes during the week of November 20. More restrictive rules with respect to revenue neutrality will apply in Senate debate and a tighter vote is expected that week. If the Senate passes a bill, differences from the House version must be reconciled in a conference committee. These negotiations may take days or weeks. If a conference agreement is reached, it will have to be adopted by both bodies and signed into law by the President.

Action plan:

We encourage you to work with us, our industry associations, and your local and state representatives this week and throughout the coming weeks to urge our representatives in Congress to have these harmful sections removed from tax reform legislation:

- *Some borrowers and issuers may not understand that their outstanding bonds are in fact private activity bonds and that future borrowings would have to be made on a taxable basis. Other borrowers planning advance refundings early next year may not be aware of the proposal for elimination of this important refinancing tool. So our clients and colleagues need to be informed and engaged.*
- *Directly contact your elected officials in the House and Senate and White House to urge the preservation of the ability to issue PABs and advance refunding bonds. Call, write or make an appointment to meet with your representatives in their Washington or district offices and make your views known.*

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- *Do not assume that your representatives understand Sections 1301 and 1302 in a 492-page tax reform proposal. Help your representatives to understand how bonds finance essential community purpose projects and how public-private partnerships work.*
- *Emphasize the 501(c)3 non-profit, tax-exempt status of projects already obtained through the lengthy IRS process.*
- *Offer to appear in media interviews or write letters to the editor to inform the public on how your industry, organization, or project will be impacted.*
- *Provide perspective by naming the project(s) in your district/state funded with PABs, the number of resulting jobs created, the number of people served.*
- *Highlight projects in the pipeline that might be adversely affected by a change as of January 1, 2018. J.P. Morgan's initial analysis shows that over the past ten years, PABs and advance refundings have averaged 27% of total issuance and \$105 billion of supply each year.*
- *Explain how your outstanding bond issues may suddenly become taxable due to draw-down provisions, a change in obligor, or rate resets; and enumerate what new taxable expenses mean to you, your bondholders and future market access.*
- *Join/activate your membership in organizations that represent like interests. The Council of Development Finance Agencies, Leading Age, the National Center for Assisted Living, and the Center for Medicare Advocacy and Medicare Rights Center are just some of many groups that are involved.*

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