THE BOND BUYER

Why Congress must reinstate advance refunding bonds

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WASHINGTON – Bond Dealers of America is urging the House Ways and Means Committee to take up and pass legislation that restores the ability of state and local governments to issue advance refunding bonds.

The group makes a case for advance refundings in written testimony it submitted on Wednesday for a post-tax reform hearing the committee held on March 14, pointing out that these transactions save issuers billions of dollars and free up funds that could be used for infrastructure projects.

It urged the committee to support H.R. 5003, a bill introduced on Feb. 13 by Reps. Randy Hultgren, R-Ill., and C.A. Dutch Ruppersberger, D-Md., which would reinstate advance refundings according to prior tax law.

The new tax law enacted in December prohibited advance refundings from being issued after the end of 2017. Prior to that, state and local governments and 501(c)(3) nonprofit organizations could advance refund their bonds once.

"The Bond Dealers of America calls on Congress to reinstate municipal tax-exempt advance refundings," said BDA CEO Mike Nicholas. "We are disappointed that the Ways and Means hearing ignored this important provision and ask that House leadership reconsider this cost saving mechanism that is so important in the financing of infrastructure in future legislation."

Advance refundings are most often used by issuers for savings. The issuers hold higher coupon bonds that are not currently callable and advance refund those bonds to take advantage of lower interest rates.

According to recent data from the Government Finance Officers Association, during the five years between 2012 and 2017, 9,000 advance refunding issues were sold nationwide, saving issuers, on a present value basis, more than $14 billion. Actual savings were much higher, BDA said.

BDA wrote in its testimony that advance refundings were prohibited by tax reform legislation “without critical public policy considerations.”

“This seemingly was done, not as a carefully thought-out policy decision, but rather [as] an accounting exercise where monies were needed to fill a gap,” the group wrote.

The $17 billion in revenue savings from the prohibition estimated by the Joint Committee on Taxation would actually be much lower now, due to issuers rushing to market to do advance refundings before the end of the year as well as rising interest rates.

Small as well as large issuers benefit from advance refundings, BDA wrote the committee. For example, Montgomery County, Texas did six advance refundings for Conroe primary and secondary education that saved more than $20 million, the group wrote.

The loss of advance refundings will severely impact the financing of core public services and infrastructure for governments across the nation, BDA wrote.

For example, more than 50 cities, schools and hospitals as well as water public transportation boards in the five largest counties in Texas have lost the ability to advance refund an estimated $6.6 billion of bonds over the next two years. The Macomb County, Michigan Drainage District will not be able to advance refund more than $20 billion of bonds, for an estimated savings of over $1.3 million.

While alternatives to advance refundings are being considered, some of them include derivative products such as forwards and interest rate swaps. These will not be “an effective replacement for advance refunding bonds,” BDA wrote.

The loss of advance refundings comes at a time when state and local governments are fiscally restrained because the new tax law’s limits on the federal deductibility of state and local taxes, the group pointed out.

“The repeal of this provision is working against the stated goal of the *Tax Cuts and Jobs Act,* to energize the economy and lower the tax burden of middle class Americans,” BDA wrote the committee. "Moreover, the significant change would restrict the primary tool that is widely and frequently used as part of financing America’s infrastructure.”

“BDA strongly requests the committee to reincorporate the cost-savings mechanisms of municipal finance advance refundings back into the U.S. tax code and consider H.R. 5003,” the group wrote.