Here's one thing wrong with the House tax plan

By Joe Cahill November 08, 2017

A little-noticed provision of the Republican tax reform plan would put a damper on the building boom in Chicago's nonprofit sector.

The tax package introduced last week in the U.S. House of Representatives proposes **eliminating a popular tax-exempt financing tool** used by hospitals, universities, museums and other nonprofits to build, expand or renovate their facilities. Locally, tax-exempt bonds have helped fund a wave of construction at high-profile institutions such as the University of Chicago Medical Center, DePaul University and the Art Institute of Chicago. Smaller organizations benefit, too, including private high schools, affordable housing developers and even startup farms.

Borrowing at lower, tax-free rates reduces financing costs, fostering critical infrastructure investments across Illinois. Without tax-exempt financing, projects would cost more and might take longer to complete. Some would be scaled back, and others wouldn't get built at all.

Higher financing costs threaten future development in a sector that has pumped billions of dollars into new facilities over the past decade or so, generating economic activity and creating jobs in the process. Pricier financing also imperils mission-critical spending at smaller nonprofits—such as equipment purchases by rural hospitals.

"It's critically important for making investments, getting the newest technologies, upgrading facilities," says Danny Chun, spokesman for the Illinois Health & Hospital Association, which represents health care facilities in the state. Chun says the association is drafting a letter urging the Illinois congressional delegation to protect tax-exempt financing for nonprofits.

The House bill targets so-called private activity bonds issued by government agencies on behalf of private entities, usually nonprofits. The private entity pays principal and interest on the bonds, which carry a lower interest rate because interest payments on government-issued securities are tax-exempt. The tax exemption is intended to encourage private investment in projects that serve broader public purposes such as health care, education and economic development.

Savings can be significant. In a letter to House Ways & Means Committee Chairman Kevin Brady, the American Hospital Association estimates tax-free treatment cuts interest rates on hospital borrowing by 2 percentage points on average. That would save $60 million in interest costs on a $100 million project financed over 30 years.

"Lower borrowing costs translate into lower health care costs for patients," the Chicago-based hospital association says in its letter to Brady. "The lower cost of tax-exempt financing also makes possible necessary upgrades and modernizations that would not be possible for hospitals with weaker finances. More costly alternatives, such as taxable bonds and bank loans, are out of reach for many community hospitals."

Some $25 billion in private activity bonds are currently outstanding in Illinois, according to the Illinois Finance Authority, the state agency that facilitates these transactions. Illinois organizations raised $4.1 billion through these bonds in fiscal 2017, which ended June 30.

Existing bonds wouldn't lose tax-exempt status under the bill. Only interest on new borrowings after 2017 would be taxable. Still, the loss of favorable tax treatment for new transactions jeopardizes financing for new projects and appears to preclude tax-exempt refinancing of previously issued bonds.

'A SURPRISE'

Nonprofit executives were **stunned to learn of the proposal** to unplug a financing mechanism they've relied on for decades. Some believed the tax exemptions were safe, but learned otherwise when House Republicans unveiled their tax plan last week. "It was a surprise," says Christopher Meister, executive director of the finance authority.

Private activity bonds appear to have been sacrificed to the broader agenda of reducing tax rates generally. Congressional tax cutters are scouring corners of the tax code **for revenue** to help plug the $1 trillion-plus budget gap their overall package would create. The tax bill also proposes dropping tax exemptions for stadium financing and other municipal funding vehicles. Congress' Joint Committee on Taxation estimates taxing interest on these now-tax-exempt bonds would raise $38.9 billion in revenue over 10 years.

In a summary of the bill, **the Ways & Means Committee says,** "The federal government should not subsidize the borrowing costs of private businesses, allowing them to pay lower interest rates while competitors with similar creditworthiness but that are unable to avail themselves of PABs must pay a higher interest rate on the debt they issue."

There are problems with that rationale. First, most private activity bond borrowers aren't commercial businesses gaining an unfair advantage over competitors that can't borrow at tax-exempt rates—they're nonprofits meeting societal needs the commercial sector doesn't address. Second, many of those needs would go unmet if nonprofits lose access to tax-exempt financing. Third, government—aka taxpayers—likely would have to fill the gap.

Also, tax-exempt bonds tap private capital for public infrastructure improvements, an approach President Donald Trump extolled during his campaign. As Meister points out, private investors decide which projects get funding, and bear the financial risk of bankrolling a new museum wing or senior housing development. He says only a tiny fraction—about $14 million—of the $25 billion in Illinois private activity bonds carry any government backstop.

"It's irresponsible to abandon a tool that so effectively uses the discipline of the capital markets," Meister says.

The good news for Meister and the nonprofit sector is that there's no guarantee the proposal will become law. Like so many proposed tax changes, the bond measure faces a gauntlet of debate, lobbying pressure and political horse-trading. Already, hospitals are mobilizing to preserve the tax exemption. If they succeed, we all win.