Potential Impact of the Elimination of Tax-Exemption

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Overview of Municipal Tax-Exemption for Bonds

- Municipal tax-exemption is a subsidy provided by the federal government to state and local governments to finance public infrastructure.

Tax Status of Municipal Issues

Governmental Bonds (Tax–Exempt)	Alternative Minimum Tax (AMT)	Private Activity Bonds (Taxable)

Governmental Bonds (Tax–Exempt)

- Valid debt obligations of state and local governments
- Interest is federally tax-exempt
- Proceeds are generally used to finance activities or facilities owned, operated, or used by a government for its own purposes
- Financing purposes can include building, maintaining, or repairing various types of public infrastructure

Alternative Minimum Tax (AMT)

- Exempt Facilities
- Qualified Mortgage Bonds
- Qualified Veterans Bonds
- Qualified Small Issues
- Qualified Redevelopment Bonds
- Qualified Student Loan Bonds
- Qualified 501(c)(3) Bonds

Private Activity Bonds (Taxable)

Meets Either:

1. Private Business Use Test
   - >10% Private Use
   - Private means not a government
   - Use means as a member of general public

   AND

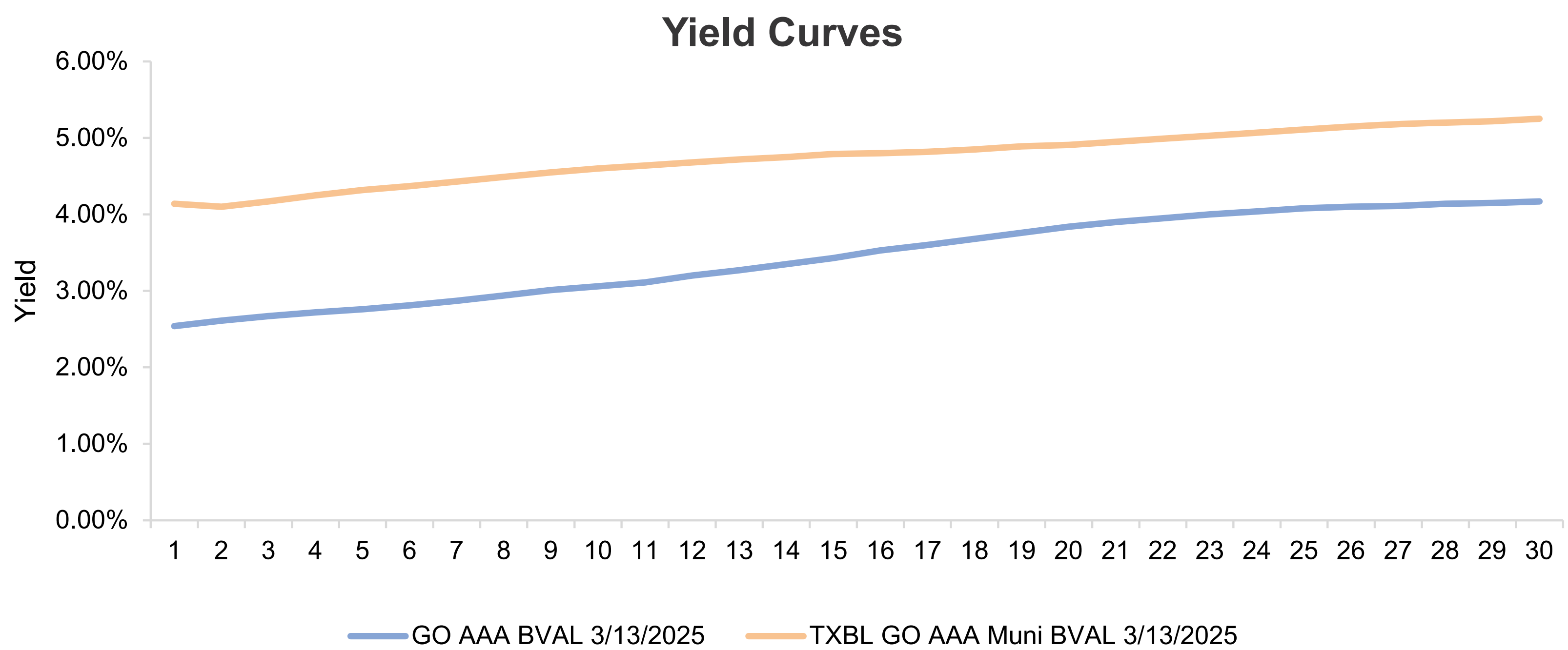
   Private Security or Payment Test
   - DS on >10% proceeds secured by private property or paid with private moneys

   OR

2. Private Loan Financing Test
   - >$5MM or 5% used to finance loans to non-governments

Why is Tax-Exemption Considered a Subsidy to Municipal Entities?

- Investors want to receive a certain rate of return. If investors have to pay taxes on their returns, they will pass the cost of any tax payments through to the borrower.
- Theoretical tax-exempt rate: (1 – Highest Marginal Tax Rate) x Taxable Rate ≈ 80% of Taxable Rate
- Actual tax-exempt ratios vary over time with current tax-exempt rates being 60-80% of allocable taxable rates (lower by approximately 1.00%-1.60% for triple-A rated securities)



Source: Bloomberg

Examples from Actual Issuances

- Two examples using actual sale results for issuers who sold tax-exempt and taxable series of bonds on the same day with the same structure:
  - Issuer A – triple-A rated state sold bonds competitively in August 2023 with a 20-year term (tax-exempt true interest rate of 3.680% and taxable true interest rate of 4.992%)
  - Issuer B – triple-A rated city sold bonds competitively in March 2024 with a 20-year term (tax-exempt true interest rate of 3.449% and taxable true interest rate of 4.856%)

	Issuer A		Issuer B	
Per $1 Million of Project Costs	**Par Amount**	**Debt Service**	**Par Amount**	**Debt Service**
Tax-Exempt	$905,360	$1,365,702	$935,311	$1,362,525
Taxable	$1,005,130	$1,510,790	$999,092	$1,526,138
Difference	$99,770	$145,087	$63,781	$163,613
% Increase to Project	10%	15%	6%	16%

Sources: EMMA and internal records

What Does This Mean?

- In addition to tax treatment, bond yields are impacted by a variety of factors including security, credit rating and liquidity translating to potentially greater impacts for smaller communities:
  - 4.00% tax-exempt rate ≈ 5.00% taxable rate
  - 4.50% tax-exempt rate ≈ 5.625% taxable rate
- Additional costs will vary depending upon the interest rate environment
- The additional taxes paid by the investor will be passed through to the issuer and ultimately constituents
- Bottom line: Borrowing for public infrastructure will be more expensive increasing the costs of projects and/or decreasing the number of projects which can be done

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