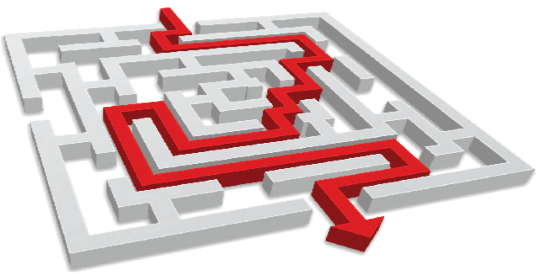
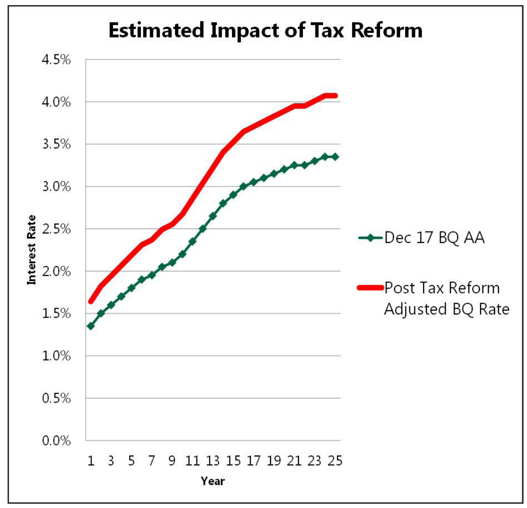


Tax Reform and Your Bond Issues

For the past three years, local governments have benefited from an unprecedented period of low interest rates. During the 161-week period from November 2014 through November 2017, the weekly Bond Buyer's Index (20-year/G.O.) rose above 4.00% only three times. Cities, counties, and school districts ("Issuers") developed a sense that these conditions were the new normal. The recent Tax Cuts and Jobs Act has burst that bubble. The Act makes sweeping changes to the Internal Revenue Code that will affect <u>every issuer</u> of tax-exempt bonds. It is clear that 2018 will be a different time for Issuers and may require significant adjustments to a new "normal."

The Act drops the corporate tax rate to one rate at 21%. Lowering this rate reduces the comparative value of tax-exempt bonds to other taxable investments. The corporate buyer, such as bank and insurance companies, have been significant participants in the tax-exempt municipal market. While some see these buyers exiting the market altogether, the consensus is that rates will have to increase for them to participate in the municipal market. Tax reform diminishes the value of Bank Qualified (BQ) designation. To illustrate this point, the chart on the right shows the interest rates needed to produce the same yield as pre-tax reform bonds.



Source: Calculations by Northland Securities, based on *"Tax Cuts and Jobs Act,"* Jan. 2018.

The effects of tax reform go beyond the direct mathematics of a lower tax rate. Unfortunately, many of the effects will evolve over time as the market adjusts. Some important factors to follow include:

- With advance refundings eliminated, will the market accept earlier call dates for new issues? Are there other ways to achieve the benefits that advance refundings provided?
- How much does a lower corporate tax rate reduce the appeal of tax-exempt bonds? Will more retail investors be attracted to municipal bonds? How will this affect tax-exempt interest rates?
- Will investors leave the municipal bond market for investment alternatives with better returns? If they do, how will it impact access to the municipal market for small issuers and more challenging credits?

Northland provides its clients with market insights that come from direct and daily interaction with investors and other underwriters. Our experienced and skilled staff uses these resources to help local governments create and implement the best possible plan for every project. As you stare into the maze of the 2018 bond market, we hope you will give us the opportunity to be your guide and gain an edge in a changing market. Call a Northland Public Finance Professional to learn more about current market conditions, the outlook for 2018, and how we can serve you.

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