Municipal Market Implications of the Tax & Budget Bill ("OBBBA")

After months of negotiations, President Trump signed into law the "One Big Beautiful Bill Act ("OBBBA")" on July 4th. While there are wide-ranging implications for the economy, individuals, and corporations, it is our opinion that the impact of the OBBBA provisions on the municipal market will be relatively modest. Near-term implications are particularly limited, as many provisions do not go into effect for several years or will be phased in over multi-year periods. Some tax-exempt sectors are likely to be more acutely impacted, but the ramifications are longer-term in nature. This horizon provides time and opportunity for issuers to adjust even if such responses do not fully mitigate the effects. Appleton believes the overall impact on the municipal market will be limited and manageable for most municipalities, particularly those already exhibiting strong fundamentals. Given our longstanding preference for investing in high-quality municipal issuers, we are not expecting to make significant changes to our clients' portfolios due to the new law. Although not inclusive of all provisions of the OBBBA, below we've highlighted the most relevant and important aspects of the bill for the municipal market.

Municipal Market Implications

Tax-Exempt Borrowing

- The ability of municipalities and other qualifying entities to issue federally tax-exempt debt remains intact. Even those issuers that sit on the peripheral of qualifying for the public good, such as corporations, stadiums, quasi for-profit projects, were left untouched.
- In fact, the ability to utilize the tax-exemption actually expanded, with "spaceports" gaining authorization to utilize tax-exempt debt, although we do not expect a wave of spaceport issuers to tap the market anytime soon.
- The status quo is also a benefit for national infrastructure, as state and local governments play an outsized role in financing essential infrastructure across the country and have been doing so for decades.

SALT Cap Expansion

- The OBBBA expands the deduction of state and local taxes from the federal income calculation to $40,000 from the current $10,000 cap. This higher threshold phases out for taxpayers with adjusted gross income above $500,000. However, the higher cap reverts back to $10,000 in 2030, likely setting up another future negotiation.
- Given the modest increase in the cap, the income phase-out, and the relatively short period the higher cap is due to be in effect, we do not feel that demand for municipal bonds will be negatively affected. Tax-exempt bonds provide an attractive avenue to generate income that is exempted from federal income tax, and investors who have benefited from the municipal tax provisions are likely to fuel sustained demand.

Municipal Credit Implications

Hospitals

- One of the most significant provisions of the OBBBA lies in changes to Medicaid, the health program funded and administered by the federal government and states.
- Changes to eligibility and access to subsidized insurance are likely to result in 11 to 15 million people losing health insurance over the next 10 years.
- For hospitals, this is expected to result in lower revenues, higher bad debts, and increased charity expenses, negatively impacting operating margins.
- In addition, the OBBBA made changes to supplemental funding mechanisms – Provider Taxes and State Directed Payments – which will also crimp cash flows.
- Almost every hospital will be impacted by these changes, but with disparate materiality. Health systems that serve a large Medicaid population and have a greater reliance on supplemental payments face the largest challenges.
- The changes in the bill strengthen our preference for investing in large, well-run hospitals with experienced management teams that serve markets with favorable demographics.

APPLETON PARTNERS, INC.

MUNICIPAL MARKET IMPLICATIONS OF THE TAX & BUDGET BILL ("OBBBA")

State & Local Governments

- Medicaid cuts will also impact states, as they share in the funding of the program. While some of the changes will be passed on to healthcare systems, states are responsible for a portion of the costs and will need to make financial adjustments to offset negative budget implications.
- States will need to increase revenues, reduce benefits, or restrict eligibility in response to the federal changes to Medicaid. Medicaid is one of the largest, if not the largest, line items within a state's budget, highlighting the important decisions lawmakers will need to address over the coming years.
- State's will also see increased costs resulting from changes to the Supplemental Nutrition Assistance Program (SNAP), with individual states becoming responsible for a greater share of the administrative costs of the program as well as a portion of the benefit costs for the first time.

Higher Education

- The bill expands an existing Endowment Tax for specific universities and colleges and creates a tiered system where some private universities will see their tax levy increase.
- Private universities with more than $500,000 in endowment per student will pay a tax on the net investment income produced by its endowment. The tax rate will vary from 1.4% (pre-OBBBA rate) to 8% for those universities with more than $2M in endowment per student.
- The tax excludes those schools with less than 3,000 students and public universities. The new exclusion based on student count will actually result in some universities not paying the tax even though they were subject to it in prior years.
- Notably, the impacted institutions, by definition, have sizeable financial resources. While the tax will negatively impact budgets, it should be very manageable for these wealthier entities.

Housing

- The OBBBA lowered eligibility qualifications for and expanded access to Low Income Housing Tax Credits, which should boost the production of affordable housing units along with the use of municipal bonds to help finance those projects.
- Although it is a niche part of the municipal market, and not a universe in which Appleton typically invests, these changes should increase issuance of single-project affordable housing bonds.

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