

City of Alexandria, Virginia
FY 2026 Proposed Operating Budget & CIP
Budget Questions & Answers

March 26, 2025

Question:

Provide an update on potential threats to the municipal bond market: Where the current legislation is? What federal administration changes are being proposed? How might that impact us?

Response:

A municipal bond is a debt security issued by a governmental entity. These bonds are issued by states, local governments, authorities, school districts and other entities to finance capital projects: long-term investments such as public buildings, schools and infrastructure. After purchasing a bond from the government, the bondholder receives semi-annual interest payments and the principal once the bond reaches maturity. Bonds typically pay on a regular schedule, providing investors a predictable income stream that is less volatile than stock holdings.

Federal law has, since the passage of the Revenue Act of 1913, exempted interest repayments on municipal bonds from the federal income taxes of investors. According to a document from the House Ways and Means Committee, Republican lawmakers proposed ending that exemption as part of a list of ideas that could potentially fund \$4.5 trillion in tax cuts over the next 10 years. The committee estimates that the removal of the exemption would net the government \$250 billion in tax income over the same period. The individual income tax cuts from the 2017 Tax Cuts and Jobs Act are scheduled to expire at the end of this year, and extending those tax cuts for 10 years would cost more than \$4 trillion.

Annually, the City issues general obligation bonds ranging from \$50 million to \$250 million, depending on the approved CIP and other funding sources. The City's bonds are usually issued in the form of tax-exempt bonds, purchased by an underwriter and sold to investors and managers of funds. Interest rates on tax exempt bonds are currently estimated to be 2 percentage points lower than taxable bonds (bonds in which the interest earned by the holder is subject to federal income tax), depending on the market and credit rating. The City's 20-year general obligation tax exempt bonds have recently been issued at approximately 3.5%. The current assumption is an increase of approximately 2 percentage points or nearly 16% to 5.5% for taxable bonds. Over the next 10 years, the proposed debt issuance averages \$113 million per year. Over the life of the bonds, the City would incur an increase in debt service of \$24.8 million per average issuance or \$1.2 million per year. In the next ten years, the CIP includes planned borrowing of \$1.127 billion. The cumulative effect of a 2% interest rate increase is \$247.8 million total over the life of the bonds or an average annual increase in debt service of nearly \$12 million. For Alexandria, this would translate into two possibilities: an impact on the operating budget in the form of higher debt service costs would require either an increase in revenue or a reduction in other areas; or fewer investments in the capital improvement program.

At this time, there is no specific legislation proposing an end to the exemption and several Republican members of the House Ways and Means Committee oppose the removal of the tax exemption. It is important to note on February 13, legislation was introduced in the House in the form of the

Investing in Our Communities Act. This bipartisan legislation would restore tax-exempt status of advance refunding bonds, allowing Alexandria and other localities to refinance our bonds at lower interest rates. The ability to refinance our bonds when lower interest rates become available was eliminated in 2017 with the Tax Cuts and Jobs Act.

There is considerable advocacy taking place from a variety of sources, including the Government Finance Officers Association and the National League of Cities. The Public Finance Network sent a welcome letter to the 119th Congress in response to the document identifying the elimination. The Public Finance Network represents industry and government associations that are impacted by or represent organizations in the municipal bond market. The message to the legislature was that the infrastructure funded by the municipal bond market “makes possible nearly every aspect of daily life and is critical in building and maintaining a strong economy for every citizen and business in the country.” It should be noted that more than 75% of the nation’s infrastructure is funded by state and local government tax exempt municipal bonds. The advocacy also points out that nearly 60 percent of the interest income is earned by individuals aged 65 or older. Municipal bonds have an extremely low default rate and provide a steady fixed-income financial investment to senior citizens.

The most likely next phase of this deliberation would occur during the ongoing budget resolution process, which is scheduled for completion on April 15th, but is highly unlikely to occur at this time. Throughout the coming months, the House and Senate will work to agree on a common budget resolution, and committees in the House and Senate will aim to develop specific legislation consistent with the numerical targets set forth in the budget resolution. The elimination of the tax exemption on municipal bonds (which would increase federal revenue) is one of the options being considered by the House Ways and Means Committee to offset other revenue reductions that are being considered in the form of tax cuts.

Staff is drafting a letter for our federal legislators, including Congressman Donald Beyer, who is a member of the House Ways and Means Committee. The letter will articulate the importance of tax-exempt bond financing to the residents and business owners of Alexandria, as well as the value of advanced refunding of our existing bonds.