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Media Alert from Houston City Controller Ronald Green

Crisis Ahead for Cities with Federal Across-the-board Cuts March 1

Eliminating tax exemption on municipal bonds could have disastrous effect for years to come

Houston and other cities across the U.S. could face a deep and long recession following automatic Federal budget across-the-board spending cuts now scheduled to go into effect March 1, 2013.

Cities across the nation have experienced declines in their revenue streams during this economic downturn, as long as six consecutive years of dwindling revenues for some cities. Most cities have managed to balance their budgets with severe and draconian budget cutting, and there simply isn't much left to cut without jeopardizing citizens' quality of life and even their safety. As you know, Houston is in a relatively enviable position in regards to revenue streams; nonetheless, we could be very badly affected by sequestration.

Just to name several vulnerable areas: Federal Community Development Block Grant (CDBG) funds are large sources of Federal aid to cities, going not just for housing but for job development, literacy training and community redevelopment. Eliminating the enhanced Federal commitment to the states' Medicaid could have a very real impact on the Houston's and Harris County's health clinics, where hundreds of thousands of citizens receive preventive and primary health care. Federal grant-funded substance abuse programs, victims' advocacy outreach, drug task forces and other law enforcement programs could face possible elimination in the near future. Title I schools—those serving disadvantage students and schools in need of improvement under No Child Left Behind—would face some serious cuts affecting those children most in need.

I am also very concerned about the disastrous effect that tampering with the tax exempt status of municipal bonds might have on cities. Tax exempt bonds have been a mainstay for cities for a century. Three quarters of all public infrastructure built by states and cities is financed by these bonds, so in a very real way the bonds contribute to job growth as well as sales and property tax revenue while keeping homeowners safe from escalating taxes.

Cities utilize municipal bonds to finance their capital projects such as roads and highways, water projects and schools, and cities save from 25 to 30 percent on interest costs with tax exempt "muni" bonds. Muni bonds have been so popular and successful for cities because they are exempt from federal taxes for the investor. Cities and states can pay bond investors lower interest rates than a corporation could, for example, because investors know their earnings won't be taxed.

In Washington DC, there has been discussion about eliminating the tax exemption on muni bonds or limiting the exemption to fewer investors as one tool to ease the growing deficit. This is more politics—on both sides—than economics.

Of special concern is the Build America Bonds program. Build America Bonds (BABs) were created under the American Recovery and Reinvestment Act that President Obama signed into law on February 17, 2009. The program expired December 31, 2010. $181 billion of Build America Bonds were issued. If sequestration takes effect March 1, 2013, BAB payments for the current fiscal year would be cut by 5.3 percent—but, because the payments extend through September, the annualized 5.3 percent would be much higher, over 7 percent.

There's no question that this is a worrisome time for cities, large and small. There is so much at stake, and if Washington fails to act responsibly cities will have few choices. The stakes are very high for our citizens—and their children.

The down side—and it is huge—in eliminating any of the muni bond tax exemptions or incentives would be that fewer investors would want to invest, and that would cause the cities to further burden the taxpayers, or simply not to proceed with needed projects. Additionally, limiting any tax exemption could cause the market to become quite fragile, even bringing losses and withdrawals. That would be felt for years to come.

There's no question that this is a worrisome time for cities, large and small. There is so much at stake, and if Washington fails to act responsibly cities will have few choices. The stakes are very high for our citizens—and their children. Now is the time for citizens to express to their Representatives and Senators their concern and their bewilderment about this budget impasse, and to urge a collaborative settlement.

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