Municipal Bonds

US municipal bond sales set to surge as curbs loom in tax reforms

Authorities rush to issue more than $20bn this week before Washington cuts exemptions

Congress moves are likely to curtail issuance in the municipal bond market © FT montage; Bloomberg; Getty Images

Eric Platt and Joe Rennison in New York
YESTERDAY

US state and local governments are racing to borrow billions of dollars before policymakers in Washington upend the tax code and limit the ability of municipalities to raise certain types of debt.

As Congress works on combining two tax bills that have the potential to curtail as much as 30 per cent to 40 per cent of annual issuance in the $3.8tn municipal bond market, local governments and revenue authorities in Maine, Florida, California and New York are set to sell upwards of $20bn this week.

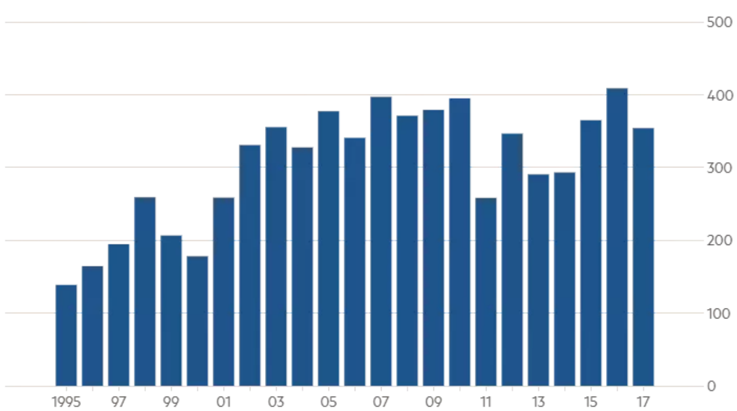
All told, borrowing could reach $45bn this month, according to portfolio managers and bankers. That would more than double last December's $18bn haul, according to Thomson Reuters.

"We are seeing a rush to the market," said Jamison Feheley, head of public finance banking at JPMorgan.

State and local borrowers have focused on two potential changes to the tax code. The first would eliminate the tax-exempt status for so-called advance refunding bonds, a type of debt that municipal governments issue to lock-in low borrowing costs before they can retire previously sold bonds. Both the Senate and House of Representatives have dropped advance refundings from their tax legislation, which investors said would all but kill that part of the market.

State and local debt issuance is expected to surge in December

US municipal bond sales, all values year to date ($bn)



Source: Thomson Reuters; Graphic: Eric Platt/FT
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However, the two chambers of Congress have not agreed on the fate of another popular type of municipal borrowing: private activity bonds. These tax-exempt offerings, known by the acronym PABs, are used by governments and non-profits to fund the development of airports, affordable housing and hospitals at lower costs. Investors are waiting for the Senate and House to reconcile their bills, with several saying they expect PABs to remain in some form.

“Issuers are trying to issue bonds before year-end because nobody really knows if they will be able to issue next year, tax-exempt or not,” said Regina Conklin, a portfolio manager at USAA. “We are still seeing issuers add to the calendar. It’s going to be a very different December for the municipal market as issuers try to get their bonds out.”

The potential elimination of advanced refunding and private activity bonds has some investors worried that municipal bond issuance could drop precipitously next year.

Peter Block, a strategist with Ramirez & Co, said it was possible that issuance in 2018 could fall by a third if both types of borrowings were axed, from what he estimated would be $400bn in bond sales this year.

Marty Bingham, head of municipal bond sales and trading at Wells Fargo, said the bank expected to see “strong investor demand for this uptick” in bond sales in December because of the looming drop in supply next year. Since the start of November, as talks over tax reform advanced, investors added $1.6bn to municipal bond funds, Lipper data showed.

Investors are also scrutinising the effect of Congressional plans to eliminate or reduce state and local tax deductions — known as “SALT” deductions. While strategists and bankers said the loss of SALT exemptions could make municipal bonds more alluring for some investors, it could weigh on the finances of higher tax states such as California, New York, New Jersey and Connecticut.

“The concern is it could change . . . to some extent the demographics of some of these states,” said Alan Schankel, a strategist with Janney Montgomery Scott. “And it makes it harder for them to raise [taxes] because it costs their taxpayers more.”