---

## Think Trump Tax Cuts Spell Doom for Municipal Bonds? Think Again.

- **Top rate cut would be too small to sap demand, analysts say**
- **AMT debt, high-tax states' bonds may benefit from changes**

President Donald Trump's push to slash corporate and individual income-tax rates would appear to pose risks to the $3.8 trillion municipal-bond market, a haven for individuals seeking interest income that's exempt from federal taxes.

But the brief outline released by administration officials had little impact on the price of state and local government securities — and could even lead some segments of the market to outperform, considering that Trump's proposal to phase out deductions could boost demand in high-tax states.

Here's a look at the major ways it may impact the municipal market if ultimately enacted by Congress, according to Wall Street analysts and investors, who remained skeptical of its prospects.

**Lower Taxes = Lower Demand?**

Any reduction to tax rates, particularly those on the wealthiest earners, would in theory weaken demand, given that the tax breaks would be less valuable. Yet, the securities have outperformed since Trump's surprise election in November, even with talk that the muni tax-exemption could be done away with by Congress.

Since the vote, municipals have slipped 0.5 percent, one third the decline posted by U.S. Treasuries, according to Bloomberg Barclays indexes. While 10-year municipal bond yields edged up 0.02 percentage point Wednesday to 2.16 percent, those yields remain below those on comparable Treasuries — reflecting the value of the tax exemption.

The proposed cut in the top-rate — from 39.6 percent to 35 percent — is too small to dampen demand for tax-free bonds, said Matt Dalton, chief executive officer of Rye Brook, New York-based Belle Haven Investments. "If you go from 39.6 to 35 and your state income tax has been climbing, I don't think you're running away from the muni bond market," Dalton said. "And if I just lost my deductions, how do I minimize taxes? The way to do it is to own tax-free municipal bonds."

**Buying Opportunity**

Among Trump's proposals was phasing out the Alternative Minimum Tax. That could be a boon to the $140 billion of outstanding municipal bonds that are covered by that tax. Those securities, which finance airports, housing agencies and non-profits, pay yields that are about half a percentage point more than traditional tax-exempt bonds because the interest is covered by the AMT. If Trump succeeds in eliminating that levy, as his administration proposed, that gap should disappear. Barclays PLC analysts previously wrote that doing away with the AMT would be "extremely positive" for those bonds.

“By eliminating the AMT, those bonds that were issued with or exposed to the AMT, now will trade closer to general market levels,” said Jeffrey Lipton, head of municipal research at Oppenheimer & Co.

**More Demand, in High-Tax States**

With lower tax rates, the Trump proposal would no longer allow Americans to deduct state and local taxes from their federally taxable income, a major deduction for residents of states with high taxes and property values, such as New York, California and New Jersey. That may actually prove positive for municipal bonds issued by governments in those states, as residents continue to seek out tax shelters.

“The deductions, except for charitable and mortgage are going away, including your state and local tax,” said John Miller, who oversees $120 billion of municipal bonds at Nuveen Asset Management in Chicago. “Your effective rate could easily migrate up. As your effective tax rate migrates up, your demand for munis — which are still tax free under this plan — would be increased.”

The biggest fear of the municipal market appeared to be averted: the elimination of the tax-exemption.

“Nobody is going after the municipal exemptions from what we know today,” Miller said. “Of course that could change, but I think it’s unlikely that they come up with guiding principles that don’t include municipals and throw municipals in later.”

**Bloomberg BNA**

by Martin Z Braun, Rebecca Spalding, and Molly Smith

April 26, 2017, 3:06 PM PDT