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Tax Bill Jolts Municipal-Bond Market.

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December is typically the sleepiest month in an already sedate municipal-bond world. But this year the prospect of a new tax bill roused the market to records.

Municipalities issued $43 billion in new bonds through the first 15 days of December, the largest amount of government borrowing during that same period since 1990, according to Thomson Reuters. The total includes $8 billion of new bonds on Friday.

The flurry of new debt triggered a series of price swings that don't normally occur in such a placid market. Within an eight-day period in late November and early December, municipal-debt values hit their low and high points for the fourth quarter, according to the S&P Municipal Bond Index.

"It's been kind of raining munis," said James Iselin, head of the municipal fixed-income team at money manager Neuberger Berman.

The price volatility unfolded as Congress debated whether to do away with long-held tax exemptions on certain types of municipal bonds. Investors don't demand as much interest on these bonds because they don't have to pay taxes on their earnings. That lowers borrowing costs for cities and states as well as charter schools, museums, private universities, hospitals and nursing homes.

A final bill hammered out last week by House and Senate negotiators eliminates the exemption on so-called advance refunding bonds, which cities and states use to refinance their old debt. The nonpartisan Joint Committee on Taxation estimates that move would mean an additional $17.3 billion in revenue to the federal government over the next decade.

Legislators decided to keep the exemption on private-activity bonds, which allow nonprofits and some for-profit firms to raise money for development projects perceived to have a public benefit. A prior House bill proposed eliminating that benefit altogether.

The full House and Senate are expected to vote on the final bill this week, and President Donald Trump is expected to sign the final version if it passes.

Borrowers and bond buyers began their scramble in November when Congress unveiled its first tax proposals. As issuance skyrocketed at the end of last month, municipal bonds reached their cheapest levels relative to 10-year Treasurys since 2015, according to Thomson Reuters Municipal Market Data.

Prices then rebounded as investors competed to buy up the new, cheap bonds. Thus far this month an average of $45 million in municipal-bond exchange-traded funds has changed hands a day, compared with $26 million in December of last year, according to a CreditSights analysis of Bloomberg data.

Even an announcement last Wednesday that the Federal Reserve would raise its benchmark federal-funds rate by a quarter percentage point didn't slacken demand. Rising interest rates tend to lower the price of outstanding municipal bonds that were issued in a lower rate environment.

"This may easily be the biggest December that we've ever seen when all is said and done in terms of new issue volume," said Peter Hayes, head of the municipal group at BlackRock Inc. and a buyer of these bonds. "Usually we're known for more straight line performance."

One reason for the demand is that many market participants expect municipal bonds to become more valuable in 2018 if governments pull back on new advance refunding bonds. Even private-activity bonds, which will retain their tax-exempt benefit under the current bill, are likely to be scarce for the first few months of the year because so many borrowers rushed to market over the past six weeks.

One borrower whipsawed by the market movements was Forsyth County, Georgia. After Congress began its tax debates, county officials decided they would issue about $70 million in advance refunding bonds used to refinance prior borrowings on parks and roads.

But when the county's documents were ready at the end of November, bond prices were lower and interest rates were higher. The county would gain little in savings, said Chief Financial Officer David Gruen, and decided to hold off.

When prices rose again this month, the county, its lawyers and underwriters changed their minds again. Mr. Gruen now expects to do the deal Wednesday if rates remain favorable.

"It is really been quite a roller-coaster ride," Mr. Gruen said.

Borrowing costs jumped as municipalities rushed to issue new bonds ahead of apotential change in tax rules.

One city, Portland, Ore., wasn't able to move fast enough. It wanted to move up an issuance of about $100 million in advance refunding sewer bonds planned for April 2018, said debt manager Eric Johansen. But officials concluded they would not be able to bring the borrowing measure before the city council and get ratings reports on the proposed bond issue from debt-ratings firms in time.

"If we had a little more time, we would," Mr. Johansen said. He said he remains hopeful that Congress will give governments a grace period. "Any kind of extension of the effective date would be enormously helpful," he said.

Plenty of other borrowers were able to take advantage of the mayhem. The state of Florida this month sold $410 million in advance refunding bonds planned for 2018, said Florida bond finance director Ben Watkins.

Another state official asked Mr. Watkins "'What are you going to do for the next six months?'" he said.

"I said 'I guess I'm going to take time off.'"

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