Bond Case Briefs

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What The New Tax Law Means For Muni Bonds.

It was clear before the final tax bill was voted on and signed by the president that Congress had the municipal bond market in its crosshairs. The laundry list of municipal bonds they potentially would curtail or disallow was long and all encompassing. The final outcome of the law could have been much worse.

As a veteran of the municipal market, I've lived through numerous trial balloons and Congressional threats regarding the tax-free status and issuance of municipal bonds. But this time Congress really voiced its distaste for Muniland.

The new tax laws will no longer allow issuers to conduct advanced refundings. That means an issuer—any issuer—cannot exchange bonds before they are due to mature for other bonds with longer maturities. So if interest rates go lower, refinancings no longer provide any relief for issuers. Those prerefunded munis that already exist will mature. The municipal bond market will shrink. The brokerage firm, Jefferies, estimates that Advance Refundings account for about 17% of the annual issuance according.

That, coupled with the new $10,000 limits for deducting state tax against one's Federal tax makes munis more attractive to upper middle class and wealthy citizens living in high tax states like New York, New Jersey, California, Connecticut and Maryland.

So the equation is pretty simple: Shrinking municipal volume plus increased demand equals a good bid for munis no matter what happens to interest rates.

Municipal bonds will be less attractive to banks and insurance companies with their lower corporate tax rates.

The new tax law reduces the incentive for leveraged corporations from borrowing. The lower corporate tax rates and new depreciation rules may be an incentive to pay down debt. That said, corporate debt issuance might decline, making municipal bonds more attractive to individual investors at the margin. As you can see, there are a lot of "ifs" and "maybes" depending on how investors and corporate America react to the new tax rules.

So what safe investments are there for individuals in Muniland? With more than 50,000 municipal issuers and over 1.5 million CUSIPs, I will share what I believe are the best and safest muni credits.

There are two categories of absolutely essential municipals I like: Large airports and large ports. Rather than list 3-5 different CUSIP numbers that you may or may not be able to find, focus just on the categories: The top ten U.S. ports and the top ten U.S. airports. Their names are familiar:

Top Ten U.S. Seaports:

Los Angeles
Long Beach
New York/New Jersey

Georgia
Miami
Seattle-Tacoma
Virginia
Houston
South Carolina
Oakland

Top Ten U.S. Airports:

Los Angeles International
Hartsfield – Atlanta
JFK International – New York
O'Hare International – Chicago
Phoenix Sky Harbor
Dallas/Ft. Worth
San Francisco International
Denver International
McCarran International – Las Vegas
George Bush International – Houston

Stick with senior liens and leave subordinated or junior debt to the others. The yield differential isn't worth it. Try if you can to buy your bonds as a new issue. This way the price you pay will be the exact same price as the Vanguard municipal bond funds, PIMCO, Franklin—all the big guys. It's the one time do-it-yourself investors can be 100% confident the price they paid is the fair and right price.

I look for 2018 municipal bond market yields to gradually improve unless some unknown inflation tsunami hits. Stick with excellent credit quality and you'll clock those coupons no matter what consequences the new tax code heaps upon us.

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