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Muni Market Facing Bond-Sales Deluge in Democrats' Budget Plans.

- **Refinancing, infrastructure subsidies would unleash new issues**
- **At the same time, tax-law changes could affect demand**

A flurry of legislative activity in Congress is promising to shake up the $4 trillion municipal-bond market by unleashing a potential surge of new debt sales and altering tax rates in ways that could affect demand from investors.

The proposals are among those included in legislation released by Democrats in the U.S. House of Representatives who are moving to implement President Joe Biden's tax-and-spending agenda.

The steps, if enacted, would upend the calculations used in the tax-exempt bond market, where valuations have surged and investors have flooded in over speculation that Biden will raise taxes on the highest earners. Yet the varying elements make it difficult to gauge exactly how it will affect prices, particularly since some elements would likely increase demand as well as supply.

One set of proposals would almost certainly set off a large increase in new bond issuance by subsidizing governments that sell taxable debt for infrastructure projects and restoring the tax-breaks for a refinancing tactic that was effectively ended by Donald Trump in 2017. That could be offset at least in part by moves to raise corporate tax rates and apply a surcharge on individual incomes over $5 million, providing a potential increase to demand.

"It's a little hard to predict how that all comes out in the wash at this point," said James Iselin, head of the municipal fixed-income group at Neuberger Berman Group.

The legislative push could inject more volatility into the state and local government bond market, where yields have been little changed since April.

JPMorgan Chase & Co. estimated that the move to allow governments to again sell tax-exempt bonds for so-called advance refundings could fuel over $100 billion of debt sales in 2022 alone. At the same time, lawmakers are seeking to revive the Obama-era Build America Bonds program, which covered part of the interest bills on taxable municipal bonds to spur infrastructure projects. About $186 billion of such debt was sold in 2009 and 2010.

The House Ways and Means Committee's proposal to raise the top corporate tax rate from 21% to 26.5%, however, could affect demand from buyers such as banks that pared their municipal-bond holdings after taxes were cut under Trump. Even so, some lawmakers are pushing to eliminate the $10,000 cap on state and local tax deductions that was widely seen as increasing demand for tax-free bonds from wealthy Americans, particularly in states like New York that were heavily affected by the limit.

Overall, though, money managers said the provisions could ease the shortage of new bonds that resulted from a steady influx of cash this year. Municipal debt sales have increased just 3.5% this

year, according to data compiled by Bloomberg.

“Most market participants feel there’s just not enough tax-exempt bonds relative to that demand,” Iselin said. “It could wake the market up from this more doldrum-like state. Everybody would be happy for that.”

A surge in debt sales would in theory weigh on performance given that the market tends to be heavily driven by supply and demand dynamics. But any selloff as a result of the expectations for higher supply would be “healthy,” said Jeff Timlin, a managing partner at Sage Advisory Services, and so far prices have barely budged.

Municipal bonds have posted small gains this year, bucking the losses seen in other parts of the fixed-income markets. And the yields on 10-year tax-exempt bonds have averaged about 66% of those on Treasuries this year, down from 106% in the second half of 2020, indicating valuations have risen.

Any pullback could “help the muni market reprice to levels or valuations that are more sustainable in the long run,” Timlin said.

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