Bonus Yields Found in Muni-Bond Niche Tax-Free to Most Americans.

As bond yields dwindle worldwide, investors are turning to a $150 billion niche of the municipal market that offers higher payouts because of the risk they'll be subject to a tax that few Americans actually pay.

The securities, which finance airports, housing agencies and non-profits, provide yields that are more than half a percentage point above typical state and local debt. That's because the interest is covered by the Alternative Minimum Tax, a federal provision that applies to about 4 million high-income earners a year. For everyone else, it's tax free.

"The demand for AMT bonds has grown because everyone is in search of yield in this yield-starved market," said Tommy Chan, a senior credit analyst in New York for Ziegler Capital Management, which oversees about $11 billion and has been buying some of the debt for clients who aren't subject to the tax. "The yields have compressed over the past year, but we still think there's value there."

Taxable debt has been among the best performing in the municipal market, in part because of money pouring in from overseas while officials hold interest rates below zero in Germany and Japan to spur economic growth. The bonds have returned 11.2 percent since the beginning of the year, more than double the 4.7 percent on traditional tax-exempt securities, according to Bank of America Merrill Lynch's indexes.

When New York's LaGuardia Airport sold $2.4 billion of the AMT debt in May, 30-year securities with a 5 percent coupon yielded 3.27 percent, about 2 percentage points more than top-rated debt, according to data compiled by Bloomberg. The price has since climbed, pushing the yield down to about 2.8 percent, narrowing the premium over the benchmark to 1.6 percentage points.

The prospect of paying the AMT — which ensures that deductions aren't used to erase most or all of one's bill to the Internal Revenue Service — has usually made the bonds less appealing to municipal debt investors, who typically look for tax-free investments with little risk. The AMT, however, has become less likely: It applied to just under 4 million tax returns — or 2.7 percent of the total — in 2013, according to data compiled by the Tax Policy Center. That's down from as much as 4.3 million in 2011.

The more one earns, the less of a concern the AMT becomes, according to Chan. For those whose income exceeds $1 million, the likelihood drops to just 18 percent, compared with 63 percent in the $200,000-$500,000 bracket.

Nor is the tax risk an issue for investors outside the U.S., who have been stepping up purchases of municipal bonds that offer bigger yields than can be found at home.

Investors are still looking to take advantage of owning more AMT bonds in their portfolios, said Rob Amodeo, head of municipals in New York for Western Asset Management, which oversees about $440 billion.

“If you have a standalone portfolio and understand your clients’ tax status that they’re not subject to AMT and don’t anticipate being subject to it in the future, then absolutely, it’s an opportunity,” he said. “It’s a strategy we’ve been using over the last few years.”

The increased demand from buyers has been a boon for public-works projects by driving down the cost of financing. AMT bond issuance totaled about $16 billion in 2015, and $12 billion has been sold already this year, according to data compiled by Bloomberg. The Massachusetts Port Authority is planning to offer $172 million next week for Boston’s Logan International Airport.

“The country has embarked on large infrastructure projects, which has been reflected in a pickup in AMT bond issuance,” Amodeo said.

Bloomberg Business

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July 8, 2016 — 2:00 AM PDT Updated on July 8, 2016 — 9:19 AM PDT