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Muni Bond Buyers Expected a Sideshow. They Got a Major Surprise.

- **Tax plan would roll back some big municipal debt programs**
- **Advanced refunding, private activity bonds would be scrapped**

Municipal bond analysts and portfolio managers expected the Republican tax plan to affect only the margins of their industry, tinkering with demand by cutting corporate rates or eliminating the Alternative Minimum Tax.

They didn't anticipate the detail on page 275 of the 429-page document: a repeal of the tax-exemption for advance refunding bonds, a major source of supply for the $3.8 trillion market. More than $37 billion of the securities have been issued already this year, according to data compiled by Bloomberg.

"This is new to me," said Jeffrey Lipton, head of municipal research at Oppenheimer & Co. "That's going to be a negative for state and local governments."

There were other surprises, too, that could further reduce the sales of new tax-exempt bonds and, as a result, make them even more valuable. One provision would scuttle the sales of so-called private-activity bonds, which businesses use to finance infrastructure projects, while another would prevent tax-exempt bonds from being used to build sports stadiums.

There was little impact on bond prices, with the bill likely to be revised heavily as it works its way through Congress. Yields on benchmark 10-year tax-exempt debt was unchanged at 2.01 percent, according to Bloomberg's indexes, while those on longer dated bonds slipped 0.01 percentage point as prices edged up.

State and local governments issue advanced refunding bonds to refinance outstanding securities that can't yet be repurchased from investors. They do that by issuing new tax-exempt debt, investing the money in Treasuries and using the income to pay off their debt as it comes due.

The tax bill released Thursday would effectively end that practice by stripping the tax-exempt status from refunding bonds, unless they are issued within three months before the bonds can be called back, a time frame so short it would likely not be worth the expense.

According to Chris Mier, chief strategist at Loop Capital Markets, the provision would substantially reduce the pace of new bond sales. "We know how large the advance refunding component is in our marketplace and how big of a role it plays. I think it would have a profound impact," he said in a telephone interview.

It's not only investors who would be affected. State and local governments would also find it more difficult to cut their debt-service costs.

"I think it's bad policy, obviously," said Mier. "It would inhibit the ability of governments to reduce

debt service costs of outstanding debt.”

Bloomberg Markets

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November 2, 2017

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