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There's One U.S. Market That Loves the GOP Tax Bill.

- **Ending private activity bonds may reduce supply as much as 40%**
- **Calendar bulks up as issuers rush prohibited deals to market**

Yesterday a man called and asked why it was so hard to find California municipal bonds.

He referred to himself not as an investor but a collector, which isn't the first time someone has likened the municipal market to numismatics or philately, where you have to know a lot about the subject at hand. I told him the objects of his affection were going to get simpler, but rarer, too.

It's all the result of the tax deliberations in Congress. The lower-house version of the GOP tax reform plan would effectively throttle muni-bond sales in years ahead, and buyers — or "collectors" like my caller yesterday — are scooping up the existing securities in anticipation of this shortage. That has triggered a torrid rally for the sector, now up 0.61 percentage points month-to-date, a move that stands in stark contrast with the sell-offs in stocks and the dollar that the tax debate has stoked.

"If this plan is implemented in its current form," wrote analysts led by Vikram Rai at Citigroup in a piece published on Nov. 8, of the House GOP tax reform plan, "municipal issuance could shrink and tax-exempt issuance will shrink dramatically thus increasing its scarcity value."

The House version of tax reform calls for an end to tax credit bonds, tax-exempt stadium finance, advance refundings and private activity bonds. Which means at least one-third and perhaps as much as 40 percent of the municipal market issuance would end with it.

The Senate version of tax reform, released Thursday night, is silent on everything except advance refundings, which it wants to abolish, too.

How much might municipal bond sales fall? Mikhail Foux, Clare Pickering and Mayur Patel at Barclays were the first ones to make a prediction in their report on November 8: "If curtailing tax-exempt issuance becomes permanent, the total 2018 supply drops to $250 billion to $270 billion and the tax-exempt portion of it gets even smaller, due to a dramatic increase in taxable muni issuance to $70 billion-$80 billion."

To put this in perspective, the last time long-term municipal sales were anywhere near $250 billion was 2001, when they totaled $261 billion, according to data compiled by Bloomberg. For this year so far, about $313 billion has been issued.

The falloff in new sales may occur even without tax reform being enacted. If the House passes H.R. 1, its version of tax reform, the effective dates for doing away with advance refundings and private activity bonds is Jan. 1, 2018. After that date, bond lawyers won't be able to give unqualified opinions about the tax-exempt status of new advance refundings and private activity bonds.

It's no wonder that the problem is especially acute in high-tax states like California and New York, where investors face the loss of their state and local tax deductions. The municipal market, or what remains of it, will be one of the only ways to shelter cash from taxes.

Over the short-term the rally in municipals may be delayed a bit. The new deal calendar seems to be fattening up as more issuers rush private activity and advance refunding deals to market before the end of the year.

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