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Here's Why Muni Bond Prices Rally Even as Market Is Deluged.

- **Steady amortization provides shock absorber for new supply**
- **Maturing bonds, calls means money is always looking for a home**

Everyone's marveling this week because the municipal market is rallying in the face of a \$21 billion-plus wave of new supply, almost triple the \$7.3 billion average this year, as issuers look to get ahead of Congress's tax reform.

The yield on the Bloomberg BVAL 10-year triple-A benchmark has fallen from 2.25% on Nov. 29 to 1.94%, even below the 2.03% it posted on Nov. 2, when the House GOP unveiled their version of tax reform and set off the bond-issuance stampede.

How was this even possible? Munis are bulletproof!

Well, yes. I hadn't fully grasped the nature of the market until the rally this week. If anything, I took for granted what we all know in the municipal market, and which mystifies tourists in MuniLand.

And that's the conservative debt management of most of the nation's states and municipalities.

Back in the days of the financial crisis, even before Meredith Whitney's famously off-target prediction about a wave of coming defaults, I remember reading some blogger who asked what municipalities were going to do when it came time to rollover all their maturing debt — a routine ingredient of sovereign debt crises. The implication was that states and cities all faced imminent financial oblivion.

But that's not how munis work — then or now. There is no big rollover, as is also common in corporate finance. I got really angry because someone was making an assertion and they didn't know what they were talking about. This sort of thing used to bother me.

States and municipalities borrow with bonds that mature serially (every year) and in terms (think of single-bullet maturities). They pay off their debt steadily over time, just as homeowners do with their mortgages. Because of that, even with a steady thrum of borrowing, for much of this year, and for the past few, the municipal market had actually been shrinking.

Until relatively recently, issuers have been retiring more debt than they sell. This year, for example, long-term issuance stands at \$357.8 billion. There have been \$439.7 billion in bonds maturing and being called.

Let's see how this works in practice. In November, \$20.9 billion in bonds matured. Another \$10.5 billion was called. That means \$31.4 billion was looking for a new home, presumably back in the municipal market.

But November was a very busy month, as private-activity bond issuers and all issuers who wanted to

use advance refundings, both of which would be prohibited under the House GOP version of tax reform, rushed deals to market. States and municipalities sold \$42.7 billion in long-term debt, both fixed-rate and variable.

Now let's look at December. At the beginning of the month, the amount issuers planned to sell over the next 30 days was calculated at \$29 billion, the highest it's been since 2005. Municipalities are rushing to beat the Jan. 1 effective date of the House GOP version of tax reform. They are even moving up deals they had planned to sell in early 2018.

So: \$29 billion in new deals are planned. There's \$27.7 billion in debt maturing; another \$12.5 billion is being called. So \$40.1 billion is looking for a new home. There's your rally.

Now, the visible supply figures don't capture every planned bond issue; in fact, they basically capture about half. It's almost like a weather forecast — very accurate up front, less so the further out you go. If we see \$58 billion in sales this month, won't yields go higher?

And the answer is: Perhaps. But keep in mind, investors know that issuance in early 2018 will be down, maybe because of new prohibitions on tax-exempt debt, definitely because so many 2018 deals were moved into 2017. Plus, \$21.7 billion in municipal bonds mature in January. We don't know yet about how many will be called; calls are announced 30 days in advance. And in February, another \$26 billion matures. And so on.

This amortization schedule is why the municipal market is bulletproof.

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