Investors Can't Buy Munis Fast Enough.

- **Even as supply surges, many deals coming in oversubscribed**
- **‘We’ve all gotten a fraction of what we’d hoped to get.’**

Congress has set off a feeding frenzy for municipal bonds.

Investors are rushing to buy debt being issued by state and local governments, leaving banks with far more orders than they can fill, despite a potentially record-setting flood of new sales this month. Some firms are borrowing so they can purchase more. And even cash from overseas is coming into a market dominated by Americans seeking income that’s exempt from federal taxes.

“Firms are taking up leverage, drawing down cash, extending duration — everything they can do to be as aggressive as they can in their portfolios,” Peter Hayes, head of municipal bonds at BlackRock Inc., said in an interview with Bloomberg radio on Thursday.

The spree was triggered by the U.S. tax-overhaul legislation that would pull the subsidies from a vast swath of the municipal-bond market starting next year, which investors and analysts say could cut the supply of new bonds by as much as a third. Faced with that scarcity, prices have rallied, sending the yields on 10-year benchmark debt on their biggest six-day drop since 2009, according to data compiled by Bloomberg.

Both the House and the Senate legislation would eliminate tax-exempt bond sales for advance refundings, a technique governments use to refinance tens of billions of dollars of debt each year. The House bill would also prevent businesses such as hospitals, airports and privately owned power companies from borrowing in the municipal market, where interest rates are lower. The two bills are currently in the process of being reconciled.

Guy Davidson, director of municipal fixed income for AllianceBernstein LP, said the buying has come from mutual funds, individual investors and banks.

“It’s been a wall of money coming in and coming from a number of different directions all at once,” he said. “We’ve been frustrated because we’ve all put in for a lot of bonds. But because there’s so much competition for the bonds, we’ve all gotten a fraction of what we’d hoped to get.”

Kyle Gerberding, director of trading at Atlanta-based Asset Preservation Advisors, said he could only get a small sliver of what he wanted from the University of North Georgia’s $88 million bond issue this week. “Unfortunately, it’s all been like that,” he said.

He’s been told by underwriters that deals have typically been 10 to 15 times oversubscribed, meaning that an investor who places an order for $1 million bonds would end up with $100,000 or less. He said he was “in an uphill battle” with larger firms, some of which are try to buy every bond in an entire deal when it comes to market.

But there’s plenty of securities still in the pipeline for December, with issuers already scheduled to sell over $17 billion of bonds next week alone, more than twice what comes during a typical week, according to data compiled by Bloomberg. BlackRock’s Hayes said he expects this month’s issuance to eclipse the 1985 record of $54.7 billion.

Investors are especially clamoring for higher-yielding tax-exempt hospital and airport securities, which would disappear after this year under the House bill. In the Long Island Power Authority’s $350 million issue last week, 10-year securities were priced at yields of 0.33 percentage point over the benchmark, down from 0.53 percentage point when it sold debt last year.

“It’s been a fever pitch up and down the credit spectrum,” said Tom Casey, a senior portfolio manager at Standish Mellon Asset Management, who said he expects strong returns to continue in the first quarter of 2018 due to a decline in bond sales. He said there’s been “tremendous appetite” from foreign investors.

It’s not only supply that the tax plan could change. By scrapping the deduction for state and local income taxes, the overhaul would increase taxes on wealthy residents of states such as New York, California and New Jersey. That has led some analysts to predict that bonds from those states may outperform, since residents may look for new ways to drive down their federal tax bill.

“Someone who knows the market should be paying attention to high tax states, if they’re not,” said Sandy Panetta, a portfolio manager at Evercore Wealth Management in New York. “They should be getting the most attention because, for sure, they will be in higher demand next year.”

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