[Bond Case Briefs]

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[Advisors To Face Tsunami Of Cash Bond Redemptions, Money Manager Says.]

Now that state and local taxes are no longer deductible from federal tax returns, many high-ne--worth individuals are looking to shelter more income in municipal bonds, such as private activity bonds, one money manager said.

“We’ve seen demand increasing for bonds issued in high-tax states like California, New Jersey, Minnesota, Connecticut and New York,” said Adam Weigold, vice president of Eaton Vance Management and senior portfolio manager on Eaton Vance’s municipal bond team. “High-net-worth individuals may have thought they were getting a tax cut, but when they consider SALT reform, many in these high tax states will see an increase.”

Private activity bonds (PABs) may appear particularly attractive because they tend to be higher yielding, especially now that their tax exempt status has been preserved by President Trump’s new tax law.

“We’ve seen the issuance of municipal bonds overall creep up on an annual basis for quite some time as the economy has grown and the needs of city, states and municipalities to finance themselves has grown,” said Weigold.

For example, 2017 saw about $436 billion in muni bond issuance.

Originally, the tax legislation did not include exempting the tax status of new private activity bonds, which had caused an issuing and buying frenzy due to the perceived scarcity value of private activity bonds.

“Much of the issuance of private activity bonds that was going to happen in the first quarter of 2018 got pulled in December,” Weigold said. “As a result, we’re going to see limited supply of these types of bonds.”

The issuance of PABs has since normalized. Generally, PABs make up about 30 percent of the municipal bond market. “If the PAB portion of legislation had passed, there’s a whole crop of issuers who would have to find an entirely new market to finance their infrastructure operations for hospitals, stadiums, roadways and schools,” said Weigold.

President Trump’s proposed $1 trillion infrastructure reform makes 2018 an exciting year for PABs overall. “Potentially, PABs would be used to finance infrastructure, which is how they are largely used right now,” Weigold said. “The Trump administration may be interested in enhancing the ability to issue private activity bonds if they want an infrastructure bill to be successful.”

Due to the sheer number of bonds that were issued in 2008, financial advisors can expect a windfall, he said. “In July 2018, we’ll see the largest month of maturities the municipal market has ever seen in any one month,” said Weigold. “If a client has a portfolio of bonds, there’s a good chance that something’s going to be called or mature this year and that cash will need to be put to work in a market where issuance is likely going to be much lower than it was last year."

Some 10 percent of the municipal bond market has consisted of advance refunding, but this is no longer permitted under the new law. The upside of the elimination is that it could lead to innovative bond structures.

"Issuers may start to issue 30-year bonds with shorter calls or maturities, like five-year calls or 10-year bonds with five-year calls or just five-year bonds, because they want the option to refinance at some point," Weigold said.

Advance refunding is a tool issuers have been using to refinance their debt before the bonds are callable or before they mature, which allows them to refinance before the 10-year call on a bond.

"The disallowance of advance refunding is going to reduce supply in the market because issuers will no longer be permitted to refinance old bonds and issue new bonds," said Weigold.

FINANCIAL ADVISOR

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