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U.S. Municipalities Selling Taxable Bonds at Near Record Pace.

- **States and local governments have sold $92 billion this year**
- **Low interest rates push borrowers to refinance tax-exempt debt**

State and local governments haven't sold this many taxable bonds in a decade.

The sellers have issued $92 billion in debt subject to federal income taxes so far this year, according to data collected by Bloomberg. That's almost a third of all the long-term municipal bonds sold in 2020 and is the most since 2010, when the Build America Bond program sunset at the end of that year.

"I'm astonished at the pace of taxable municipal bond sales," said Kathleen McNamara, a senior municipal strategist at UBS's wealth management arm.

Sales of taxable municipal bonds were on the rise late last year, a byproduct of falling interest rates and President Donald Trump's 2017 tax-cut law that took away the power of states and cities to sell tax-exempt bonds for a key refinancing technique known as advance refunding. But the pace surged this year after borrowing costs fell to record lows, allowing issuers to refinance debt with taxable securities that cost less than what they are paying on outstanding tax-exempt bonds.

"As long as taxable yields remain low and tax-exempt advance refundings remain restricted, municipalities are likely to continue to take advantage of refinancing opportunities through the taxable municipal market in the months ahead," McNamara, along with Thomas McLoughlin and other members of UBS's wealth management research team wrote in a note to clients published Sept. 10.

States and local governments sold $154 billion in taxable bonds in 2010 as the Build America Bond program — created under President Barack Obama to subsidize public works projects and jump start the economy — shut down at the end of that year.

Nisha Patel, a portfolio manager at Parametric Portfolio Associates LLC said it's possible this year's volume could top that, especially if Congress doesn't pass another round of stimulus payments and cash-strapped municipal governments trim spending by refinancing higher-yielding debt.

"It certainly could happen," she said. "I wouldn't be surprised if we see more issuers come to the market well before election time saying 'Let's make sure we can issue it at these low rates just in case we need it.'"

Taxable muni bond yields fall and spur more refinancings
Taxable muni bonds generally have longer durations and lower default rates than corporate bonds, making them a useful substitute for crossover buyers, according to the UBS analysts. Those attributes, combined with the surge of new sales, have opened the market to overseas investors who wouldn't benefit from the tax-exemption anyway. International buyers hold about $107 billion in

municipal securities as of the first quarter, according to Federal Reserve Flow of Funds data.

A 10-year AA-rated taxable municipal bond yields about 1.64%, or 21-basis points higher than a 10-year AA-rated corporate bond, according to Bloomberg BVAL pricing data. That's luring in investors who normally wouldn't buy municipals, especially as corporate bond yields remain depressed because of Federal Reserve intervention.

"This is all about yield pickup and the associating risk and making sure you are getting compensated for it," Patel said. "That is resonating with non-traditional muni buyers who wouldn't consider buying them otherwise."

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