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The Municipal Market May Be on the Brink of a Dramatic Shift.

We believe the municipal bond market is on the brink of major changes. The Biden administration has proposed legislation that, if passed, could meaningfully increase both taxable and tax-exempt supply in the municipal bond market. While this potential shift could cause some short-term disruption, we believe it could result in more balanced supply and demand over the medium term.

Revisiting Trump's Tax Cuts and Jobs Act

To explain the impact of the proposed changes, we need to revisit how the Tax Cuts and Jobs Act (TCJA) of 2017 affected the municipal bond market. In our view, the TCJA significantly changed supply and demand in the municipal market in three key ways:

- Tax-exempt issuance fell sharply because the TCJA prohibited advance refunding of tax-exempt debt with tax-exempt issuance.
- Taxable issuance rose more than four-fold as supply shifted from the tax-exempt market to the taxable market.
- The State and Local Tax (SALT) deduction limitation fueled demand from individual investors in high-tax states.

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