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Muni-Bond Appeal for Wealthy Seen Easing With a Higher SALT Cap.

- **Congress mulls proposals to raise state, local tax deductions**
- **'Incremental demand would likely decline,' says Lord Abbett**

The revival of proposals in Congress to increase the cap on state and local tax deductions threatens to erode some of the demand in the \$4 trillion municipal bond market from rich Americans.

Democrats are deciding between at least two proposals to change the limit imposed in the 2017 tax law revision. That change capped state and local tax deductions at \$10,000, an unpopular move with wealthier Americans in high-tax states such as California, New York, Connecticut and New Jersey who sought to ease the impact on their tax bill with investments in tax-exempt bonds.

"If this cap was lifted, then the incremental demand would likely decline a bit" in the highest-tax states, said Eric Friedland, director of municipal research for Lord Abbett & Co., which holds \$36 billion in muni assets. Still, any higher taxes at the federal, state or local level would serve to counter the impact and "further enhance the relative value of municipal bonds," he said.

The SALT cap helped propel record flows of cash into municipal-bond mutual funds, which have seen 37 straight weeks of gains, according to Refinitiv Lipper US Fund Flows data. Year-to-date, investors have added \$78.2 billion to muni funds, according to the Investment Company Institute. The record inflows have helped keep yields from rising too far above historic lows set in 2020 as demand overwhelmed the supply of bonds coming to market.

Demand has topped muni supply, keeping yields tight

That growth rate into mutual funds would slow as wealthier Americans in higher-tax states would see their tax liability lessened if the cap is increased, said Cooper Howard, director of fixed income strategy for the Schwab Center for Financial Research. "I would expect that we would not see new record inflows in mutual funds and ETFs," Howard said in an interview.

A potentially higher cap is one piece of a "shifting landscape" and could spur "modestly" higher muni yields, Howard said. The benchmark 10-year muni rate is hovering around 1.1%, which is relatively low by historical comparisons and investors have been on the look out for higher yields.

"Raising the limits on SALT can help undo some of the nosebleed prices bonds in both NY and CA have experienced since 2017," said Eric Kazatsky, an analyst for Bloomberg Intelligence.

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