## Special Municipal Market Commentary: The Tax Cut and Jobs Act (H.R. 1)

The U.S. House of Representatives released its draft tax reform bill, the Tax Cut and Jobs Act (H.R. 1), on Thursday, November 2, 2017. While the bill itself is nowhere near final and multiple efforts will be made to amend several of its provisions prior to it being enacted into law, there are a few themes directly related to the municipal bond market.

***The views expressed herein reflect opinions regarding the municipal bond market and are not legal advice, interpretation of legal terms or tax treatment, or a recommendation regarding any particularized municipal security or financial product.***

### How does the proposed tax reform bill impact municipal issuers and conduit borrowers?

H.R. 1 includes provisions to eliminate the tax-exemption for interest for bonds that are advance refundings and for private activity bonds (including bonds issued on behalf of 501(c)(3) corporations, airports, toll roads, student loans, and bonds issued by housing finance agencies to finance mortgages to low-to-moderate income and first-time homebuyers, among others).

### What are next steps in the legislative process?

The House Ways and Means Committee is taking up amendments to the bill beginning November 5th. The Senate is expected to release its own tax reform bill by November 10, 2017. Currently, members of Congress are publicly targeting having a final bill voted and passed by Thanksgiving.

Adding complexity to the situation, the continuing resolution to fund the federal government and the related bill to temporarily increase the debt ceiling expire December 8, 2017. This will be additional, time consuming, yet essential legislative work for Congress to achieve in relatively short order.

### Municipal bond market impact and considerations – near term

For upcoming new issues of any type, investor demand will be impacted by investors' calculus of the likelihood of the bill's passage and appetite for potentially increased supply ahead of year-end 2017. Pricing conditions will likely have more variability due to the external impact of headlines surrounding House and Senate versions of their tax reform bills, resulting in more variation in price levels and spreads to benchmarks like MMD.

If the elimination of advanced refunding and private activity bonds remains in the tax bill, we expect a significant increase in issuance for the second half of November and in December. This could emulate the expiration of the Build America Bond program when we experienced some of the heaviest weekly issuance totals in the history of the municipal market. This supply wave would heighten the pricing variation already expected from a dampened investor demand profile, likely a double negative impact to municipal bond performance versus other fixed income products, albeit only a short-term characteristic. Regardless, for many of our clients a small underperformance for municipals, translated in wider benchmark spreads (MMD), is likely a non-event because of the savings created by going forward with an advance refunding in 2017.

For issuers not impacted by the tax bill, there is a possibility for a significant January outperformance within municipals once the supply wave subsides. This may vary depending on investor demand changes following the passage of a final tax bill.

New issue pricing conditions will be impacted in the coming weeks as final bill(s) move through Congress. Comments reflect our views as of November 6, 2017.

Municipal bonds are today considered a meaningful part of an overall diversified portfolio for any individual investor of moderate size. We will continue to tracked mutual fund flows as a gauge for mom and pop reaction to potentially lower tax rates. Most commentary before the announcement of the tax bill expressed analyst expectations for minimal, if any, impact due to a lower individual tax rate. How corporations and banks treat municipal income in light of reduced tax rates and/or deductibility will need more clarification for all participants before any impact on demand can be predicted.

### SOURCES:

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