Advisory Blog

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Legislation | Municipal Bonds | Taxes

How President Biden's infrastructure spending plan might impact municipal bonds

By: Bill Delahunty, CFA | & Nisha Patel, CFA | April 30, 2021

Boston & New York - Continuing our series looking at proposed fiscal policy through the lens of municipal bonds, we turn next to the American Jobs Plan (AJP) announced at the end of March. This $2.25 trillion proposal from the Biden/Harris administration would invest significantly in infrastructure across the U.S., suggesting there would be a lot of money flowing to municipal credits. While major provisions could have significant market impacts, it may be too early to tell exactly how they would affect munis in particular.

Taking a broad view of infrastructure

AJP takes a broad view of infrastructure, encompassing not only transportation, clean water and energy, broadband and power grid improvements, but also education, housing and care for children, seniors, veterans and those with disabilities. Here are some highlights:

- $621 billion for transportation infrastructure, including $85 billion on public transit, $25 billion on airports and $80 billion on passenger and freight rail service
- $400 billion on elderly and disability care
- $300 billion on American manufacturers and small businesses
- $213 billion on affordable and sustainable housing
- $111 billion on clean drinking water initiatives
- $100 billion on electric grid investments

Many of these spending programs may bolster muni bond issuers. The plan is expected to be credit positive for numerous municipal sectors, including state and local governments, as the additional federal money would revitalize or help construct new infrastructure assets, without the need for additional debt at the project level.

Historically, state and local government spending on infrastructure has averaged close to 1.5% of GDP, while federal spending has been below 0.5% of GDP. Only when the final bill is written will we know how far the additional federal expenditures will move the needle on overall infrastructure spending.

Funding the AJP could boost muni technicals

Unlike both the CARES Act and the COVID Relief Bill in 2020, and the American Rescue Plan passed last month, the AJP bill will have to be paid for — at least partially through potentially raising corporate tax rates from 21% to 28%, as detailed in the Made in America Tax Plan released on March 31. While often overlooked, corporate buyers account for approximately 20% of the municipal market buyer base, and the tax rate increase may boost their demand for tax-exempt investments as they seek higher after-tax returns. That could be a positive technical factor for the muni market.

Along with increasing the corporate tax rate, more individual tax policy reforms have been proposed as part of the $1.8 trillion American Families Plan (AFP) announced on April 28 — including changes to the preferential treatment of long-term capital gains and returning the top marginal income tax rate to 39.6% for the top 1%.

Here are other potential provisions that are worth monitoring as the Biden bills are finalized:

- Eliminating the cap on the state and local tax (SALT) deduction, which could shift demand in high-tax states from in-state municipal portfolios to more nationally diversified issues.
- Repealing the exemption on tax-exempt advanced refunding in the muni market, which should increase tax-exempt supply relative to taxable issuance.
- Reviving the Build America Bonds (BABs) program, which would encourage issuers to tap into the taxable municipal market. Created by the Obama/Biden administration in April 2009, this subsidized program was responsible for $181 billion in taxable muni issuance before expiring in December 2010.

The tax changes to meet the funding requirement also mean the AJP — and AFP — will likely face challenges from Republicans in Congress. Unless passed through the budget reconciliation process, these bills would need support from at least 10 Senate Republicans. We will look more closely at the AFP and munis in our next blog.

Bottom line: The details of the final AJP bill passed by Congress will ultimately determine how President Biden's infrastructure spending plan will impact the municipal bond market. However, additional federal expenditures on infrastructure would definitely be a positive for municipal credit, while higher corporate and personal taxes would be a supportive technical factor for muni bonds as the value of the tax exemption would increase.

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Picture of Bill Delahunty, CFA

Bill Delahunty, CFA
Director of Municipal Research
Eaton Vance Management

Picture of Nisha Patel, CFA

Nisha Patel, CFA
Director Fixed Income Portfolio Management
Parametric

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