ELECTION IMPACTS ON THE MUNICIPAL MARKET

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With less than a month until Election Day, many races are too close to call, including control of the White House, leading pundits to predict a split Congress, and the maintenance of a thin majority in each chamber. The final results will affect a variety of upcoming negotiations, including federal tax reform. With several tax code provisions set to expire next year, any policy revisions could influence the demand for municipal bonds. Below, we highlight some proposed changes along with a quick look at the docket of ballot measures that may impact supply.

A number of provisions in the Tax Cut and Jobs Act (TCJA) of 2017 are set to expire at the end of 2025 including:

- Changes to individual marginal tax rates
- Limitations on State and Local Tax (SALT) deductions
- Alternative Minimum Tax exemption and phaseouts

Although neither candidate has fully articulated their plans regarding all elements of the sunsetting policies, certain positions have been expressed by both sides.

Under TCJA, the top individual tax rate was lowered to 37%. Former President Trump is calling for a permanent extension of all rates under the Act. Vice President Harris proposes an extension of current rates only for those earning less than $400,000, while returning the top rate to 39.6% for taxpayers above the threshold. Higher marginal rates will translate into greater demand for municipal bonds.

Additionally, TCJA imposed a $10,000 cap on state and local tax (SALT) deductions. Trump favors the removal of the limit, while Harris has not offered an opinion on the issue. If the limitation is removed while rates remain at current levels, demand for in-state paper could soften across high-tax states.

The Alternative Minimum Tax (AMT) was greatly reduced under TCJA with the number of AMT taxpayers falling to approximately 200,000 in 2018 from just over 5 million a year earlier. If the provision is not extended, more taxpayers will become subject to AMT likely causing spreads on the bonds to widen, thereby increasing borrowing costs for issuers reliant on AMT paper, primarily airports and housing agencies.

Capital gains taxes also have been a topic of debate with Trump favoring the status quo, while his opponent has floated an increase of the all-in top capital gains rate to

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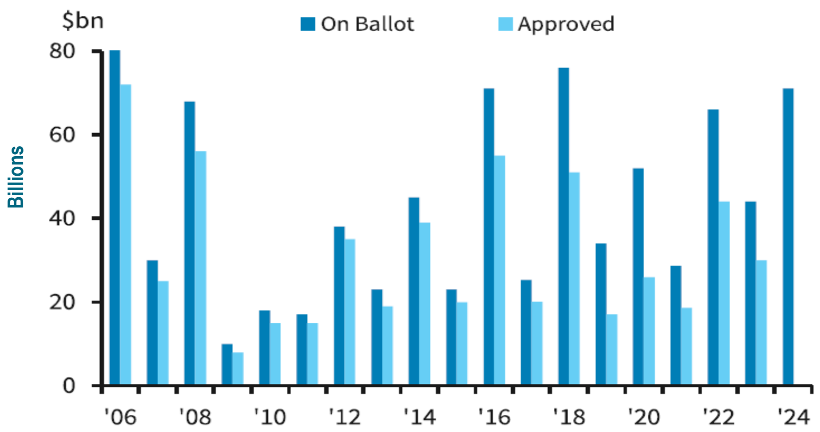
33%. A higher rate will be favorable for municipals as the tax-exemption becomes more attractive in comparison to other assets.

Both candidates have discussed changes to the corporate tax rate. Trump suggests lowering the tax to 20% (15% for companies that make their products in the US) from the current rate of 21%, while Harris recommends raising the rate to 28%. Continuing to lower the business tax will further diminish corporate demand for municipal bonds, while a higher levy will make the sector more appealing to banks and property and casualty insurers.

Any discussion of tax reform and deficit reduction raises the question of whether the municipal exemption is at risk. We do not see any threat to the treatment of outstanding municipal bonds, however, prior budget negotiations have often revisited the value of preserving the exemption. As we have stated in prior commentaries, we view the elimination of the exemption as an unappealing fiscal strategy since it penalizes state and local governments that are tasked with building and maintaining the nation's infrastructure.

The election cycle provides state and local governments an opportunity to place ballot measures before voters on a number of policies including infrastructure spending. According to a recent report by Barclays, over $70 billion of bond authorizations will be presented to voters in November, the highest level since 2018. As evidenced by surprisingly strong issuance this year, government borrowing is on the upswing driven by lower rates, easing inflation pressures and depleted pandemic assistance.

Bond Approvals on Ballots
2006 – 2024*



* 2024 is estimated
Sources: Ballotpedia, Barclays Research

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Although the outcome of the election remains unclear, it is widely anticipated that the next administration and Congress will be negotiating tax reform and deficit reduction. Any policy changes that increase individual, corporate and/or capital gains taxes will translate into greater demand for municipal bonds. The impacts of modifications to the AMT or the SALT deduction will need to be evaluated in the context of other key elements of the final tax package. We are encouraged by the large volume of bond authorizations on the November ballot and expect voter support will result in a healthy slate of borrowing for 2025 and beyond.

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