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Gridlock can be good for the muni market

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Though congressional control remains uncertain after a tight midterm election, public finance lobbyists say market-rattling policy shifts are unlikely next year and that they'll stick to bond basics to educate new lawmakers heading to Washington.

But the next two months may be a different story as the lame-duck session tackles bills that may have a direct impact on the muni market.

"A divided Congress and gridlock are always good for markets, even the municipal market," said Emily Brock, the federal liaison for the Government Finance Officers Association. "Gridlock would allow for, in theory, the administration to think intuitively about how to roll out the infrastructure plan and how to make appropriations happen and make sure the goals of the infrastructure law are carried out."

"A divided Congress and gridlock are always good for markets, even the municipal market," said Emily Brock, the federal liaison for the Government Finance Officers Association.

As of Wednesday, the election outcome remained uncertain as an expected wave of Republican wins failed to materialize and several races remained too tight to call. The GOP is expected to gain control of the House by a narrow margin. Senate control is up in the air and may hinge on a Georgia runoff on Dec. 6.

GOP control of the House would mean new leadership on key committees that write the tax and fiscal policies that affect the muni market. Muni advocates say they plan to renew their efforts to educate lawmakers of the importance of key muni items, like the tax exemption.

"We do not know about leadership changes in the House or the Senate," said Charles Samuels of Mintz Levin, counsel to the National Association of Health & Educational Facilities Finance Authorities. "From the point of view of the public finance community, it means that however this plays out, we have to continue our advocacy. After all, we tell the truth to everybody."

Brock said an initial review of new representatives didn't show much state or local government experience.

"We have worked very hard to have a bipartisan municipal finance caucus, which will remain our primary goal moving forward," she said.

With the midterms over, even if the results are not yet in, all eyes will now turn to the lame-duck session. Top of mind is the Financial Data Transparency Act, a bill requiring standardized issuer disclosure that's expected to be tucked into the must-pass 2023 National Defense Authorization Act. The House has already passed the bill, and the Senate is expected to take it up as soon as next week.

Other lame-duck legislation that may impact the municipal market include the so-called PAYGO budget rule, which, if it isn't waived by year's end, would affect direct-subsidy payments on Build America Bonds and other direct-pay paper. If the debate over the debt ceiling lingers, it could affect a little-known program called the state and local government securities program, or SLGS, which are used by state and local governments and other tax-exempt issuers for escrows in current refunding and for equity defeasance escrows that are yield restricted. Treasury has been forced to suspend the program in the past to preserve cash.

Returning to the outlook for the 118th Congress next year, Brett Bolton, vice president of federal legislative and regulatory policy for the Bond Dealers of America, said the lack of a certain outcome for either chamber the day after the election was "shocking," but doesn't change the outlook much for the next two years.

"The narrow margins lower the likelihood of brawls over the debt ceiling or government funding or potential attacks on the tax-exemption to lower the deficit, bringing some long-term fiscal stability across the board," Bolton said.

The threat to the tax exemption, the municipal market's most closely held treasure, may have eased with the lack of a red wave, said Tom Kozlik, head of strategy and credit at HilltopSecurities Inc.

"If the Republicans don't get control of Congress and don't get control of the White House in 2024, we're that much further away from a potential threat to the tax exemption from that side," Kozlik said, adding that the progressive Democrats may pose their own threat.

Like Brock, Kozlik said a slowed-down policy-making pace may benefit public finance. The 2017 Tax Cuts and Jobs Act, the 2021 Infrastructure Investment and Jobs Act and the 2022 Inflation Reduction Act, illustrate how quickly major legislation can advance under one-party control, he said.

"They were put together in a matter of weeks, and if that's what happens, issuers and investor groups won't have time to go in and educate lawmakers," Kozlik said.

One outcome on the state front – the strong support for a $4.2 billion environmental bond in New York State – may bode well for the bond market nationally, said Mike Stanton, director of strategy and communications at Build America Mutual.

The measure's approval "shows that even after the IIJA and IRA, there's a bipartisan appetite for states and local governments to use their bonding authority and do more," Stanton said. "It's a great opportunity to move infrastructure back into the spotlight during the next election and to make sure Congress understands the importance of the tax exemption to the communities they represent."