COLUMBIA THREADNEEDLE INVESTMENTS

Infrastructure and the outlook for municipal bonds in 2022

December 15, 2021

The Infrastructure Investment and Jobs Act is one of several positive drivers for municipal bonds in the new year.

After months of debate, Congress passed the $1.2 trillion Infrastructure Investment and Jobs Act ("IIJA"), which was signed by President Biden November 15. The act aims to increase American competitiveness by modernizing the country's infrastructure. For municipal investors, the Biden program is another positive driver as we head into 2022.

New supply, but not too much

The most significant impact of the IIJA for municipal bond investors is likely to be incremental supply of muni bonds. All else equal, increased supply can put upward pressure on yields. However, in this case, provisions of the bill (and clear omissions) may serve to limit a glut of new bonds. Initial proposals to include a program like Build America Bonds, for example, failed to make the final bill. Additionally, better-than-expected state and local tax collections through the pandemic and recovery have resulted in budget surpluses for many state and local issuers, which can use surplus funds to finance their contributions to infrastructure projects.

Timing the impacts

Spending under the IIJA plan will occur from 2022 to 2026 to allow for necessary planning of these long-term projects. No official timelines have been released for when spending will begin, but with federal spending spread out over five years, related municipal debt would arrive in the market gradually, which will also help to alleviate a supply deluge.

Infrastructure Investment and Jobs Act Spending Provisions

$110 billion for roads and bridges

$66 billion on upgrading passenger and freight railways

$39 billion for modernizing mass transit

$25 billion for airports and **$17 billion** for ports

$73 billion for the electric grid and renewable energy

$65 billion to expand broadband access

$55 billion for water and wastewater, including $15 billion for lead water pipe replacement

$50 billion on infrastructure resilience

$5 billion for electric school buses

Source: whitehouse.gov

Catherine Stienstra
Head of Municipal Bond Investments

Douglas Rangel, CFA
Vice President, Fixed-Income Client Portfolio Manager

Henry Henderson
Municipal Research Analyst

Implementation efforts will be funded through grants from federal agencies such as the Department of Transportation and the Department of Energy. An estimated $300 billion of IIJA spending will be executed through formula grants, including increased funding for the Highway Trust Fund (HTF), and we expect this infrastructure spending to be implemented first. California and Texas currently receive the most funding from the HTF and we expect that will continue.

One of many positive drivers for the muni market

Heading into 2022, the municipal market finds itself on solid fundamental footing. The combination of strong tax revenue and unprecedented federal stimulus has largely eliminated credit concerns from 2020, and robust equity market returns have improved pension funding ratios for most issuers (meaning that the municipalities have enough money to both fund pensions and pursue infrastructure projects). The IIJA is poised to add to these positive drivers by providing a boost to economic growth. Many economists have noted that construction spending from the bill should increase GDP growth by around 0.2% in the first few years, with benefits extending beyond that due to efficiencies from upgraded infrastructure. Historically, job growth and increased economic activity have led to higher tax revenue collection for state and local governments.

It is no secret that fixed-income bonds (measured by spreads) are expensive, and municipal bonds are no different in that regard. However, bonds can remain expensive, as they did for extended periods in 2006-2007 and the lead-up to the COVID selloff, especially if the economy continues to grow. As such, we expect income to outpace price return in its contribution to total returns in 2022. That should not preclude investors from actively seeking to generate alpha from security selection, though, and robust research resources will be required to examine the breadth of the muni universe, including issues that are outside of benchmarks, to find bonds that may outperform.

Bottom line: The IIJA is another reason to invest in active muni funds and strategic beta muni ETFs

Record inflows in 2021 were, in part, motivated by the threat of higher taxes, which has not come to pass … yet. Funding provisions for the Biden administration's other signature legislation, the Build Back Better bill, have yet to be determined. Whether tax rates move higher or not, we believe that the income generated from municipal bonds remains attractive and is one of few avenues for sheltering income from taxation. We remain constructive on the prospects for municipals in 2022 given healthy fundamentals, strong continued demand and manageable new supply levels. That said, expect dispersion in the new year, and employ active approaches to find risk-adjusted income opportunities.

To find out more, call 800.426.3750
or visit columbiathreadneedle.com

COLUMBIA THREADNEEDLE INVESTMENTS

Not Federally Insured	No Financial Institution Guarantee	May Lose Value

CTBPZ1S4 (12/21) 3937330