Bond Case Briefs

Municipal Finance Law Since 1971

California Finds Wells Fargo Absence Doesn't Dent Demand.

California Treasurer John Chiang's decision to ban Wells Fargo & Co. from underwriting state debt isn't interfering with demand for the securities of the municipal market's biggest issuer.

Citigroup Inc., Morgan Stanley and Jefferies LLC each bought portions of California's $1.65 billion general-obligation bond deal Tuesday, with 10-year tax-exempt securities priced to yield 1.93 percent, according to data compiled by Bloomberg. That's about 0.2 percentage point more than benchmark securities, a gap that's narrower than the 0.24 percentage point difference for debt issued by Washington, which is ranked two steps higher than California.

In a deal in which Loop Capital replaced Wells Fargo earlier this month, 10-year lease revenue bonds were priced to yield 1.94 percent, or about 0.19 percentage point less than an index of similarly-rated revenue securities, data compiled by Bloomberg show.

While politics are at the forefront, what's got investors' attention is the state's economy. Tax collections beat projections in September for the second straight month, according to the state controller. A real-estate market revival and an economy driven by Silicon Valley's technology industry, coupled with measures such as automatic allocations into reserves, have helped turn around a spate of deficits into surpluses.

"We like what's going on there," said Nathan Harris, senior analyst in Boston for Appleton Partners, which manages $7 billion in municipals and will consider buying some of the debt. "They certainly have the economic tailwind."

Even through the extra yield on California 10-year debt over top-ranked securities is creeping up, it's far short of the 0.67 percentage point high most recently reached in June 2013.

Although Wells Fargo is barred from underwriting negotiated bond offerings for a year, the firm could have won Tuesday's competitive deal because of laws requiring the state to pick the lowest bids, said Chiang's spokesman Marc Lifsher. Gabriel Boehmer, a spokesman for Wells Fargo, said he couldn't comment before the sale, which Lifsher said is likely the last general-obligation one for the year.

The winning banks should find eager buyers. High tax rates on the wealthiest residents boost the value of the tax exemption of the securities. Even with lower yields, "if you're a California resident and you're in the one of the top tax brackets, it can still be attractive for you," Harris said.

At the same time, headwinds loom. With income-tax revenue dominated by the wealthiest, who tend to own stocks, California is highly susceptible to equity-market swings. Temporary increases in sales and income taxes approved in 2012 — which helped the state rebound from the recession — will expire. Governor Jerry Brown's administration expects that the loss would help create a $4 billion budget gap by fiscal 2019-2020.

A November ballot measure asks voters if the income-tax hikes should continue through 2030. But even its rejection wouldn't necessarily set back the state, said Ben Woo, senior analyst in Minneapolis for Columbia Threadneedle Investments, which manages $24 billion in local debt. He said it might deter lawmakers from spending beyond their means, which would boost the state's creditworthiness. The firm may consider buying the new securities, he said.

"With the low double A rating and the strong economic recovery in the state in general, it gives a reasonable level of comfort to investors," Woo said.

Bloomberg Business

by Romy Varghese

October 18, 2016 — 2:00 AM PDT Updated on October 18, 2016 — 11:02 AM PDT