Bond Case Briefs

Municipal Finance Law Since 1971

December Muni Volume Hits Record $62.5B Ahead of Tax Overhaul.

Municipal bond issuance set a new single-month record in December as issuers rushed to close deals before the new tax law took effect with the New Year.

Data from Thomson Reuters (TRI) shows volume in December ballooned to $62.50 billion in 1,168 transactions from $20.81 billion in 780 deals from the last month of 2016. The issuance surpassed the previous record of $54.7 billion of deals in Dec., 1985, just before the last comprehensive tax overhaul took effect.

Back then, issuers rushed to market on fear of tax reform only to have the legislation delayed until September. This time around, the frenzy started in early November on concern that the municipal market would lose the tax exemption on both private activity bonds and advance refundings.

The flood of issuance also resulted in a 2017 total of $434.76 billion, closer than expected to the yearly issuance record, of $451.65 billion that was set in 2016. Of the 2017 total, $144.61 billion came in the fourth quarter.

"By our estimate, the tax bill rush resulted in about $35 billion of issuance was pulled forward in 2017 and taken away from 2018," said Sean Carney, director and head of municipal strategy at BlackRock (BLK). "It begs many questions about the New Year, including what it means for the overall market performance and volume in 2018 but also volume in the first quarter of the year."

Tom Kozlik, managing director and municipal strategist at PNC, said he wasn't surprised by the surge in November and December and that volume would have been even greater if there'd been more time.

"For months, tax reform had been in the pipeline and no one could have guessed a threat to the tax exemption would have emerged for a tax cut," he said. "Issuers responded how I think they should have, by assuming the worst case scenario. And they were able to mobilize and execute some financings before year end. Investors soaked up several weeks of $20 billion-plus supply easier than expected."

Carney agreed, saying that what surprised him the most, was how easily digested the volume was, as many deals were oversubscribed. He predicted issuance will fall to about $335 billion – down 21% year over year, but only 13% off from what the market was on pace for this year, before the tax reform rush.

"It's harder to predict what it means for performance," he said. "The month of January over the past five years turns in about 45% of all returns but it looks like 2018 will bring a net negative year by about $50 through $60 billion, taking us back to a year like 2011. We will be going from a growing market in to a shrinking one in 2018. Returns from municipals were phenomenal in 2017, as rates did not move as much as people anticipated. 2018 will be a year of carry and more reliant on coupon."

The new tax bill was signed into law by President Trump on late December, keeping PABs as is for now, but ending advance refundings, a popular and important cost-saving instrument.

"Advance refundings over the past 5 years account for around 22% of all issuance," said Carney. "One highlight of the whole situation could be how PABS were saved. Maybe it means that Washington views the muni market as an avenue to fund infrastructure. Down that road, PAB s could get redefined, especially the alternative minimum tax portion."

Kozlik bank product solutions, like derivatives or interest rate swaps, could be employed effectively as an alternative to in certain situations.

"It would make sense for some issuers to lock in forward rates with derivatives when appropriate," he said. "It is also possible that the uses of synthetic advance refundings are structured by using fixed payer swaptions. It is quite possible that municipal entities begin to use these types of strategies more often.

Issuers might also toy with a five-year call, instead of the traditional 10-year call, to offset the loss of advance refunding.

"Demand, creates supply. If there is demand for issuers to come with shorter call dates, then its quite possible we could start seeing more of that," said Carney. "That being said, the muni market is very traditional and accustomed to certain 10-year non-call structure."

Refundings accounted for $28.49 billion in 492 deals, up from $5.57 billion in 227 transactions during December of 2016. New money deal volume grew to $27.31 billion in 595 sales from $13.02 billion in 502 deals.

The value of combined new money and refunding deals for the month rose to $6.69 billion from $2.22 billion a year earlier. Issuance of revenue bonds increased to $48.29 billion, while general obligation bond sales gained to $14.21 billion from $8.33 billion.

Negotiated deals jumped to $52.69 billion from $14.16 billion, while competitive sales increased to $6.83 billion from $3.91 billion. Taxable bond volume vaulted to $6.79 billion from $2.29 billion, while tax-exempt issuance expanded to $52.84 billion.

Deals wrapped by bond insurance rose 70.2% year-over-year to $2.92 billion in 121 transactions from $1.72 billion in 123 deals.

California remained the state with the most volume. Issuers in the Golden State have sold $67.59 billion this year. New York came in second with $48.45 billion, followed by Texas with $41.62 billion. Illinois was fourth with $21.57 billion and Pennsylvania rounds out the top five with $20.47 billion.

"The threat to the tax exemption is now very elevated," said Kozlik. "If Washington lawmakers can put the municipal bond tax exemption on the chopping block for a tax cut, what happens when they get serious about deficit reduction?"

By Aaron Weitzman

BY SOURCEMEDIA | MUNICIPAL | 12/29/17 07:07 PM EST