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Closing of SLGS Window Will Affect 3 Types of Muni Transactions.

WASHINGTON — When the Treasury closes the window at noon Friday on the purchase of state and local government securities it will add complexity and costs to the municipal bond market for three types of transactions.

“Any time the SLGS window closes, it causes an inconvenience and an increase in costs to state and local governments,” Shaun Snyder, executive director of the National Association of State Treasurers, said in an email Wednesday.

The SLGS window is closing as the Treasury begins to take extraordinary measures to prevent breaching the nation’s debt limit after it is reset on Saturday.

At midnight Friday the current suspension of the debt limit expires.

The nonpartisan Congressional Budget Office reports the national debt stood at $21.9 trillion at the end of January and the new debt ceiling will reflect additional borrowing that has occurred between Jan. 31 and March 1.

SLGS purchases are being suspended until Congress acts to set a new debt limit or once again suspend the debt ceiling for a period of time.

SLGS are typically used by state and local governments and other entities that issue tax-exempt municipal bonds because of yield restrictions and arbitrage rebate requirements under the Internal Revenue Code.

The role of SLGS has been significantly diminished by the termination of advance refundings under the Tax Cuts and Jobs Act, with the amount of SLGS outstanding declining about 32%.

There were 15,254 SLGS bonds and notes with a combined value of $61.4 billion as of Jan. 31 of this year compared to 21,015 SLGS bonds and notes valued at $94.4 billion at the end of 2017, according to the Treasury.

Rich Moore, president-elect of the National Association of Bond Lawyers and partner at Orrick Herrington & Sutcliffe in San Francisco, said there still are three uses for SLGS.

First, they are sometimes used for escrows in current refundings. They also are sometimes used for equity defeasance escrows which are yield restricted. The third use is for longstanding advance refunding escrows.

Current refundings represent the smallest share of SLGS use, Moore said. “No one is buying SLGS for a 7-day escrow, but if it’s 30 to 90 days they might well buy SLGS,” he explained.

“An equity defeasance may come up because someone is taking a remedial action and needs to

defease the non-qualified bonds," Moore said, explaining the second use for SLGS. "Or an issuer may do an equity defeasance of bonds for business reasons. If there's a long-term defeasance escrow for non-callable bonds, that escrow is going to be yield restricted."

Moore said that three years ago SLGS weren't needed for an equity defeasance, but he's now seeing a use for them "in a minority of cases" where the defeasance escrow is capable of earning a yield in excess of the bond yield.

"And in those circumstances it's nice to be just able to apply for SLGS to get a perfect escrow," he said.

The third continued use for SLGS in the municipal bond market involves longstanding advance refundings.

"There are some advance refunding escrows out there or equity defeasance escrows from way back," Moore said. "Those are the ones who are probably least happy with having the SLGS window being closed, because they will have to find a different way to invest the proceeds while the SLGS window is closed."

Issuers can make yield reduction payments to the Treasury to remain in compliance.

However, Moore said, "Now all of a sudden they've got to hire a rebate analyst or undertake that burden themselves. It's been so long since anyone has been able to earn arbitrage there's not many escrows like that left. I know of some."

"It's frankly one more mouth to feed," Moore added.

Snyder echoed Moore's sentiment that state and local governments will cope with the closing of the SLGS window.

"Just as they have in the past, state treasurers will adapt and will keep their hopes up that the SLGS window will only be closed for a short time," Snyder said.

The SLGS window has previously closed 13 times since 1995, most recently between Dec. 8, 2017 and Feb. 12, 2018.

By Brian Tumulty

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