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Muni Market Dynamics Driven By Strong Demand And Weak Supply.

Summary

- **Demand for municipal bonds appears to have recently exceeded the pace of new supply, amid consistently positive fund flows.**
- **Holdings of muni bonds have notched up by more than US\$17.5bn year-over-year in the fourth quarter of 2018 to a total of nearly US\$3.7trn, according to SIFMA/Thomson Reuters.**
- **Against this backdrop, and among the deals in the pipeline, the Commonwealth of Massachusetts is poised to offer US\$400m worth of Government Obligation Bonds.**
- **The proposed GO bond issuance is slated to be sold through competitive, electronic bidding via PARITY on May 7.**

US\$400m of Long-dated Mass GO Bonds Hit Radar

Issuance in the primary U.S. municipal debt market has generally resided at low levels, while increased interest from mutual funds and insurance companies has helped the asset class to outperform.

Demand for municipal bonds appears to have recently exceeded the pace of new supply, amid consistently positive fund flows.

For the week ended April 24, Thomson Reuters/Lipper U.S. Fund Flows reported a net inflow of roughly US\$1.28bn into municipal bond funds – not including ETFs such as the iShares National Muni Bond fund (NYSEARCA: MUB) and the Vanguard Tax-Exempt Bond fund (NYSEARCA: VTEB).

Holdings of muni bonds have notched up by more than US\$17.5bn year-over-year in the fourth quarter of 2018 to a total of nearly US\$3.7trn, according to SIFMA researchers and data sourced by Thomson Reuters.

Accounting for most of the uptick, mutual funds and insurance companies have upped their take by 2.42% and 3.67%, respectively, while banking institutions shed close to 13.1% from the prior year to almost US\$526bn.

The most recent fund flows data marked the 16th straight week of inflows, with long-term municipal funds having received more than US\$2bn.

Analysts at Janney Montgomery noted that recent muni outperformance has been “especially evident on the long end of the curve,” with the 30-year Muni-Treasury ratio falling to 90%, the lowest in more than six years.

They observed that weak supply and strong demand underlies the strength in the municipal market, and the trend seems “likely to continue as investors continue to pour cash into municipal funds and

ETFs (US\$32.bn in 2019),” while new issue issuance languishes.

April’s supply volume is expected to come in at around US\$22.5bn, the lowest level to date in 2019.

Janney Montgomery added that while the Bond Buyer 30-day visible supply – at US\$8.8bn – is the highest in a month, this week’s primary calendar of US\$5bn is “quite manageable, especially in the high demand environment we’ve occupied this year.”

MASS GO

Against this backdrop, and among the deals in the pipeline, the Commonwealth of Massachusetts is poised to offer US\$400m worth of GOs (Consolidated Loan of 2019, Series C) alongside three additional US\$100m GO tranches (Series D, E and F).

Most of the Series C issuance comprises longer-dated notes, with serial maturities beginning in 2039 and extending to 2049, with proceeds to be applied towards the financing of certain capital projects aligned with the state’s 2019 investment plan.

The proposed GO bond issuance is slated to be sold through competitive, electronic bidding via PARITY on May 7, with Public Financial Management (NASDAQ:PFM) serving as the municipal advisor on the ‘AA’-rated deal.

Moody’s Investors Service attributed its investment-grade ‘Aa1’ credit rating on the transaction to Massachusetts’ “continually growing economy, anchored by education, healthcare and technology sectors.”

Moody’s analyst Genevieve Nolan noted that the commonwealth’s “strong economy, combined with close monitoring of revenues and ample executive authority to make mid-year cuts, have resulted in balanced budgets.

“Strong year-over-year tax revenue growth, along with prudent planning, have afforded the commonwealth the opportunity to build up reserves.”

She added that while debt and pension liabilities are among the highest in the country, “these figures include borrowing and benefits for local governments.”

As of June 30, 2018, Massachusetts’ net pension liability in governmental activities totaled a little more than US\$31.3bn, with total long-term debt obligations up nearly US\$162m year-over-year to roughly US\$6bn.

Indeed, concerns about public pensions continue to plague muni market participants.

According to the 2019 Smith’s Research & Gradings Annual Municipal Bond Analyst Survey, conducted by Tom Kozlik, public pensions remains the number one issue/trend facing the municipal bond market. This finding was derived from 85% of the 155 analysts who responded.

At 55%, issuers’ level of fiscal preparedness for the next recession was the second most concerning, which Smith’s Research & Gradings highlighted as “notable because this topic was not even included in our 2108 survey.”

Mass revenue collection beat the March benchmark

Meanwhile, Massachusetts Department of Revenue Commissioner Christopher Harding said earlier

in April that preliminary revenue collections for March totaled US\$2.67bn, US\$316m, or 13.4%, above the revised monthly benchmark, and US\$427m, or 19.0%, more than the actual collections in the same year-ago month.

The original benchmark for fiscal year 2019 was around US\$28.4bn, however as part of the fiscal year 2020 Consensus Revenue process, it was adjusted to almost US\$28.6bn on December 31, 2018.

Harding continued that corporate and business revenue, as well as the non-withholding income tax, which are “generally volatile, were the primary contributors to the above-benchmark performance for the month.”

He added that withholding and sales and use tax, the two largest revenue categories – also associated with overall economic conditions in the state – showed continued growth over the prior year.

While Massachusetts’ economy remains diversified, the state’s government touts its knowledge-based technology and service industries as its strongest components, which compels it to rely heavily on a highly educated workforce.

Overall, the state’s economy, with its concentration of higher education institutions, life sciences and medical industries and high technology companies has outperformed the broader national economy during and immediately following the most recent recession. It also maintains an unemployment rate about average for the New England region and below the nation’s 3.8% March 2019 pace.

Seeking Alpha

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