S&P: U.S. Oil-Producing States' Fiscal Preparedness Varies As Prices Collapse

NEW YORK (S&P Global Ratings) March 11, 2020–A sustained period of low oil prices is likely to generate negative credit pressures on U.S. oil-producing states (Alaska [AA/Stable], Louisiana [AA-/Stable], Montana [AA/Stable], New Mexico [AA/Stable], North Dakota (AA+/Stable), Oklahoma (AA/Stable), Texas (AAA/Stable), and Wyoming (AA+/Stable)). While shock declines in commodity prices are not new, the timing of this latest rout has potential to upend recent fiscal and economic improvement. It was not until last year–nearly five years after the last price rout–that S&P Global Ratings observed all oil-producing states having positive economic growth (see "With Oil Price Volatility, Recent Economic Gains In U.S. Oil-Producing States Are at Risk," published March 12, 2019, on RatingsDirect). If prices do not rebound quickly or if states fail to make timely budget adjustments, we may see varying degrees of lower-than-expected year-end results for fiscal 2020.

Any sharp pull-back in exploration and production is likely to inflict considerable strain on the economies of oil-producing states, particularly those that lack diversification. Should those states slip back into an economic recession, the three hardest-hit employment sectors will likely be construction, natural resources, and mining; manufacturing; and trade, transportation, and utilities.

The price shock will likely result in many states reconsidering current revenue forecasts and revising proposed fiscal 2021 budgets. S&P Global Ratings recently lowered all of its West Texas Intermediate (WTI) and Brent Henry crude oil price assumptions this week (see "Unrestrained Supply Swamps Oil Outlook: S&P Global Ratings Revises Oil & Gas Assumptions," published March 9, 2020, on RatingsDirect). WTI was revised to $35/bbl for 2020 and to $45/bbl for 2021 from $55/bbl. For fiscal 2020, most states had a price assumption of $50/bbl or higher when enacting their budgets.

S&P Global Ratings has long held that the outsized budget reserves of oil-producing states have provided an effective fiscal cushion during a transition to lower oil prices. Over the past five years, a changing economic outlook and a wide range of fiscal adjustments resulted in an easing of the negative pressure facing state credit quality. However, a fiscal shock to these states, so soon after their economic recovery, is likely to create a challenging budgetary environment.

What we are watching in oil-producing states

Alaska, the state most reliant on oil-related revenue, has depended on reserves to balance its budget since fiscal 2015. A period of austerity and using its vast investment earnings for general operations have provided recent budget relief as traditional reserve balances declined. However, equity market volatility and low oil prices, with already deep expenditure cuts, may limit the state's fiscal flexibility.

While Texas is the nation's largest producer of crude oil and natural gas, its economy has generally shifted toward broad diversification spurred largely by strong demographic trends and growth in the technology and service industries. Nevertheless, the state's extensive oil and gas activities have contributed to its strong economic growth. Following the last oil price shock, Texas' economy grew faster than all other oil-producing states, with real economic growth among the top ten of all states nationally.

Given their size, North Dakota and Wyoming are highly susceptible to energy market volatility, undergoing significant employment growth and contraction during the energy market's boom-an--bust cycles. While mining-related revenue makes up a significant portion of the states' budgets, each has sizable operating reserves to offset revenue volatility. However, Wyoming has been running substantial operating deficits for years as the result of declines in coal severance tax, which increased oil production has not entirely offset. Louisiana, which previously used one-time budget measures (including using reserves) to balance its budget, has over several years continued to work to strengthen its reserves position to help cushion potential economic softness.

Oil-related revenue makes up a small portion of Oklahoma's and Montana's budgets. However, oil production is a significant generator of statewide employment. Oklahoma was already seeing revenue softening this year. A prolonged suppression of oil and gas prices is likely to disrupt business activity and consumer spending, weakening income and sales taxes (Montana does not have a sales tax).

New Mexico, similar to other oil-producing states, has used recent increases in revenue to address pent-up service demands with fiscal 2020 budgeted expenditures increasing nearly 12% year over year. However, the state still has very strong reserve levels, budgeted at 25% of recurring spending. The state legislature has approved a fiscal 2021 budget with further boosts in expenditures. However, the governor has not yet signed it, and based on the recent oil price drop, is likely to announce substantial line-item vetoes to create a cushion against potential revenue decline, with an emphasis on cutting one-time spending.

This report does not constitute a rating action.

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S&P: Lower Oil Prices May Create Budget Pressures For Some U.S. Local Governments And School Districts

Table of Contents

Key Takeaways

- A prolonged period of low oil prices could pressure employment, assessed valuation, and the

general economic outlook of local governments throughout oil-producing states.
- We believe that sales tax revenues are at greatest risk for significant declines in oil-producing states, based in part on historical performance during the previous period of low oil prices.
- Risks vary across states given industry exposure, particularly when considering the different facets of upstream, midstream, and downstream operations.

[Continue reading.]

[A Lot of 'Game Show' Pricing In Muni Market: Kazatsky (Radio)]

MUNIS in FOCUS: Eric Kazatsky, Senior U.S. Municipals Strategist for Bloomberg Intelligence, discusses the hi-yield muni rout, and airport economy risk. Hosted by Lisa Abramowicz and Paul Sweeney.

[Play Episode]

Bloomberg

March 13, 2020 — 10:53 AM PDT

[Risky Munis Haven't Fallen This Much Since Trump's Election.]

- **Muni high-yield index fell 1.5% each of the last two days**
- **Airlines, tobacco bonds lead decline in worst month since 2016**

The coronavirus is crushing high-yield municipal bonds.

Risky state and local government debt issued on behalf of airlines, oil companies, or backed by a national settlement with tobacco companies has declined 1.5% each of the last two days as investors were spooked by the impact the virus and crashing oil prices will have on the economy. VanEck Vectors High Yield Municipal Index ETF, the biggest high-yield municipal bond exchange traded fund, declined more than 8% during the first two days of the week, though it pared those losses with a 0.4% gain as of 11:31 a.m. Wednesday.

"We're probably in for a little bit of a rocky market for a while," said Dan Solender, head of municipal debt at Lord, Abbett & Co. "The energy sector is not huge for us, but there's still a lot of investors out there that see high-yield taxables having their issues and then just decide they're going to pull money out of high-yield munis."

High yield niche sees biggest rout since Trump's win
The last time high-yield municipal bonds fell more than 1.5% in a day was Nov. 14, 2016, following Donald Trump's election, as investors speculated his plans to cut taxes and boost spending would spawn inflation and erode the value of tax-exempt debt. They were wrong on both counts. Investors later flocked to tax-exempt debt after the Republican tax-bill limited state and local tax deductions and curbed the supply of new bonds by doing away with a major refinancing tactic. Underlying inflation has remained tame, although asset prices have ballooned.

Funds are selling their most liquid bonds like tobacco to raise cash for redemptions, according to

Solender.

The Bloomberg Barclays Municipal Bond High Yield Index is down 3.1% this month. It declined 6% in November 2016.

Bloomberg Markets

By Martin Z Braun

March 11, 2020, 8:45 AM PDT

Muni Bonds Plummet as Virus Fallout Throws Market into Freefall.

- **10-year municipal-bond yields climb as much as 24 basis points**
- **Municipals are getting 'mauled' as retail investors pull back**

For days, there was one corner of U.S. financial markets that seemed oddly impervious to the turmoil wreaking havoc this month: the municipal-bond market.

On Wednesday, the comparative calm in the safe haven of the state and local debt market came to an end as prices were poised for their worst drop in at least nine years.

Yields on 10-year benchmark state and local government debt jumped 22 basis points to 1.15% as of 1:00 p.m. Wednesday, heading for the biggest one-day leap since Bloomberg's records began in 2011. Yields on long-dated bonds rose 24 basis points.

"The muni market is getting mauled," said Matt Dalton, chief executive officer of Belle Haven Investments, which oversees $11.5 billion of municipal debt. "Hedge funds are dumping yield, flows are negative as everyone wants to re-balance portfolios toward equities, which we believe may be too soon to do that."

The financial turmoil caused by the worsening outbreak of the coronavirus sent yields on the safest assets to new lows earlier in the week as global equities tumbled. But after stock prices stabilized, municipal-debt prices slumped Tuesday, and accelerated the drop Wednesday, erasing earlier gains. The swings struck the new issue market, where some state and local borrowers shelved planned deals, indefinitely postponing offerings that had been scheduled for months.

"Obviously, we had not anticipated the market volatility due to the coronavirus, oil situation, and the FOMC's emergency rate cut when our original sale date had been set," said Mark Mathers, the chief financial officer of Washoe County School District in Nevada, which postponed a $215 million sale set for this week.

The spreading virus poses risks to sectors like high-yield municipals, which have seen spreads widen, and airports, which are at risk of people avoiding flights. Some investors may be trying to sell certain securities that could be impacted by the virus. VanEck Vectors High-Yield Municipal Index ETF, the biggest high-yield muni ETF, has declined 8.5% since Friday.

Municipal-bond mutual funds lost $250 million during the week ended March 4, ending 60 consecutive weeks of inflows to tax-exempt funds, according to Refinitiv Lipper US Fund Flows data. Jeffrey Lipton, a managing director at Oppenheimer & Co., said he wouldn't be surprised to see another week of outflows when they report on Thursday.

“As long as the volatility continues and the uncertainty with Covid-19, I think we can expect to see some continued credit concerns, credit pressure — which obviously flows from high-yield upward to even the higher-quality credits,” Lipton said.

The state and local government sell-off marks a sharp reversal from much of the last 14 months, when demand for state and local government debt seemed insatiable. Record inflows drove down bond yields even on the riskiest segments of the market and some investment-grade bonds in high-tax states traded better than AAA-rated benchmark yields.

A New York City general-obligation bond that matures next year traded as high as 0.95% yield Wednesday, more than double the yield on a one-year Treasury bond.

Belle Haven Investments’s Dalton said that the market’s bid-wanted lists are “massive in terms of line items” and many securities aren’t receiving any interest.

“The last time I saw deals like we are getting today was when Meredith did her 60 Minutes interview,” he said referencing, Meredith Whitney, the financial analyst who erroneously predicted in December 2010 that the coming year would see a wave of municipal defaults.

Bloomberg Markets

By Danielle Moran, Martin Z Braun, and Amanda Albright

March 11, 2020, 10:41 AM PDT

Frantic Muni Sell-Off Sends Yields Surging Most on Record.

- **30-year benchmark yields surge 51 basis points to 2.32%**
- **‘I don’t think anyone knows what’s going on,’ investor says**

America’s state and local government bonds are usually a haven from financial havoc. Not this time.

Waves of panicked selling are racing through the $3.8 trillion market, causing prices of even the safest securities to tumble and driving up 30-year yields by an unprecedented 51 basis points Thursday. The amount of securities being put out for bid by investment managers has surged as they rush to raise cash. And municipal junk bonds — like those backed by airlines or state tobacco settlements — are in the midst of the biggest rout in more than two decades.

“I have never seen cuts like this,” said Matt Dalton, chief executive officer of Belle Haven Investments, refering to the swift drop in prices.

The sell-off marks a dramatic about face for the municipal-bond market, where prices rose steadily until last week as the securities acted as a refuge from the stock-market’s slide. Yet even as investors flocked into Treasuries Thursday, state and local debt yields surged by the most on record, as those on 30-year securities soared to 2.32% from as little as 1.38% Monday, according to Bloomberg’s benchmark indexes.

“It’s up one day big, it’s down one day big,” said Jason Appleson, a portfolio manager for PT Asset Management LLC. “I don’t think anyone knows what’s going on.”

The fear about the steadily spreading coronavirus is raising the risk of another mass exodus from the market, which is dominated by risk-averse individuals who tend to pull back in droves when prices drop. That happened in the wake of the last recession because of misplaced speculation that there would be widespread defaults and again in 2013 on concern about rising interest rates.

The unprecedented risk of a potentially virus-induced recession is making individuals reluctant to invest, and a downturn in consumer spending and travel could hit airports, convention centers and others that have issued municipal bonds. But analysts say this week's selling has been driven more by fear than credit risk.

"Historically when there have been scares like this, it creates panic selling because of the investor base," Appleson said.

The type of securities held by high-yield funds were particularly hard hit. Some backed by Ohio's share of the legal settlement with cigarette companies tumbled to as little as 87 cents on the dollar, a 13% drop from the average price on Wednesday. Puerto Rico sales-tax-backed bonds also fell.

Yet even bonds that have essentially no risk of defaulting, like those backed by the states of California and Maryland, also dropped. The yield on top-rated 10-year bonds is now about 1.65%, more than twice what it is on comparable Treasuries. That's the biggest gap since at least 2001.

"Those are like 2008-type figures," said Gabriel Diederich, portfolio manager at Wells Fargo Asset Management.

That diverging direction of Treasuries and municipal bonds is threatening to compound the losses for some investment funds, which frequently make side bets against Treasuries to protect against the risk of higher interest rates. Those losses are coming just as investors are pulling out cash, forcing them to sell municipal securities to meet the redemptions.

The amount of bonds out for bids reached $2.5 billion Wednesday, the most since 2016, as investors look to get out of their holdings, according to data compiled by Bloomberg.

"They're getting hit on both sides," said Christopher Lanouette, a managing director for CIBC Private Wealth Management, who said he's getting more defensive in the current market environment. "It's difficult to have a lot of conviction."

Bloomberg Markets

By Amanda Albright, Fola Akinnibi, and Martin Z Braun

March 12, 2020, 9:24 AM PDT Updated on March 12, 2020, 10:46 AM PDT

Bond ETFs Face Toughest Liquidity Test Yet in Virus Turmoil.

- **Fixed-income funds are trading at discount to net asset values**
- **Arbitrage isn't compelling amid bond market upheaval: Perlman**

Bond ETFs are highlighting signs of liquidity stress in broader markets, with cash prices trading at persistent and deep discounts to the value of the underlying assets.

The $31 billion iShares iBoxx $ Investment Grade Corporate Bond ETF closed at a discount of 3.3% to its net asset value on March 11, the largest such divergence since 2008, according to data compiled by Bloomberg. Meanwhile, the $23 billion iShares 20+ Year Treasury Bond fund's price has dropped 5% below its net-asset value, the most ever. And even the U.S. municipal market is feeling the squeeze: The VanEck Vectors High Yield Municipal Index ETF traded at a record 8.3% discount on Wednesday.

The historical volatility roiling American bond markets has created unprecedented dislocations in the ETFs that track them. But the market makers who normally step in to repair price inconsistencies, pocketing a virtually risk-free profit, are cautious. That's because their standard process has become significantly more complicated with many of their usual price gauges are out of whack.

It's not uncommon for an ETF to drop below its net-asset value — but it is unusual to see a continuation of that. In normal market environments, such a decline presents an arbitrage opportunity for certain middlemen known as authorized participants. Typically market markers will buy shares of the ETF as its price drops and redeem these shares with the issuer in return for the underlying bonds. The authorized participant will then sell those securities to capture a relatively risk-free profit. By reducing the supply of ETF shares, the fund's price typically returns to tracking the fund's net asset value.

But as the coronavirus outbreak unleashes historical turbulence in financial markets and liquidity dries up, ETFs spanning the bond spectrum are trading at steep discounts. That dynamic will likely persist until volatility subsides and market makers have a better sense of where they can sell the underlying debt, according to UBS Global Wealth Management's David Perlman.

"The market price is going to drop down to where the authorized participant believes that they'll be able to trade the bonds. They're not doing this out of the goodness of their hearts," said Perlman, an ETF strategist at the firm. "They don't jump in until they think they can execute the redemption and make a profit from doing so."

The inherent rub is that fixed-income ETFs, which trade on exchanges and behave like stocks, are much more liquid than the securities they hold. That's fueled fears that in the event of a sell-off, investors scrambling to redeem their holdings would overwhelm the managers, or the traders that channel bonds into and out of the funds. The likes of Mohamed El-Erian of Allianz SE and Scott Minerd at Guggenheim Partners have suggested they could act as a potential destabilizing force in illiquid credit markets where they have an outsized trading share.

Now, as credit spreads blow out and investors rush for the exit, fixed-income ETFs are being put to the test. That has Peter Tchir at Academy Securities concerned that authorized participants — in the process of selling the underlying bonds to lock in the arbitrage — will exacerbate the sell-off.

"That means, to me, that we are about to enter a cycle driven by arbitrage, where there is more pressure on short-dated corporate than the market can handle, causing a vicious cycle," Tchir, head of macro strategy, wrote in a note Thursday.

So far, there's little evidence to support the theory. But there have been a few early success stories: High-yield bond ETFs. The iShares iBoxx High Yield Corporate Bond ETF, ticker HYG, ended Monday with a modest discount of half a percentage point to its net-asset value even as its price dropped by the most since 2009. The ETF actually added $409 million of inflows that day, suggesting that despite the steep sell-off, there were buyers to be found.

And while shifting cash on a short-term basis may be more challenging this week, buy-and-hold investors likely haven't been impacted by the turmoil — beyond the price of their investments falling.

“If you’re a long-term investor who’s looking to add an ETF position to a portfolio of bonds, for example, the trading liquidity becomes less important,” said Patrick Luby, senior municipal strategist at CreditSights.

Still, it’s crucial to be cognizant of each market’s idiosyncrasies, according to UBS Wealth’s Perlman. While this episode likely isn’t the ETF liquidity reckoning that naysayers have called for, the ease of trading an ETF is ultimately dictated by its underlying market.

“We remind our clients that you do want to take into account the liquidity of the underlying market because ultimately that liquidity is going to be reflected in the price of the ETF during these challenging periods,” Perlman said. “The ETF wrapper makes it easier to trade, but it doesn’t make liquidity costs disappear.”

Bloomberg Markets

By Katherine Greifeld

March 12, 2020, 10:55 AM PDT Updated on March 12, 2020, 2:19 PM PDT

Fixed-Income ETFs Are Trapped in Bond Market’s Liquidity Crunch.

- **Bonds ETFs trading at steep discounts as liquidity vanishes**
- **Arbitrage opportunity less attractive amid swings: Schawel**

As fixed-income markets buckle under wild swings and scarce liquidity, the strain is starting to show in bond exchange-traded funds.

Cash prices in some of the most actively traded bond funds are now at steep discounts to the value of their underlying assets. The largest debt ETF — the $74 billion iShares Core U.S. Aggregate Bond fund — closed at a 4.4% discount to its net asset value on March 12, the largest divergence since 2008, according to data compiled by Bloomberg. Meanwhile, the $31 billion iShares iBoxx $ Investment Grade Corporate Bond ETF’s price fell 5% below its net-asset value on Thursday, also the largest discount since 2008.

The havoc is reigniting arguments around fixed-income ETFs, which trade much more liquidly than the assets they hold. Critics have long warned the products were a pressure point that would crack in volatile times, as investors rush to redeem their holdings during a sell-off. But just as many arguments exist that ETFs give participants in less-active markets better prices in times of stress — and an exit route.

“The ETF at least gives you some way to get out if you need to. you’re going to pay up for it, but if you have to get out, at least there’s liquidity somewhere,” said Eric Balchunas, senior ETF analyst at Bloomberg Intelligence. “The distance between the ETF and the NAV provides a great measure of the liquidity in the underlying market.”

Rampant turbulence across bonds markets is souring appetite for the arbitrage opportunity that normally keeps ETF prices in lockstep with a fund’s value. Normally, middlemen known as authorized participants will buy shares of a falling ETF in order to exchange for the underlying bonds with the fund's issuer. That market maker will then sell those securities to pocket a virtually risk-free profit. The ETF's price usually snaps back to the fund's net-asset value as the supply of ETF shares is reduced.

But fear over the coronavirus's economic fallout has unleashed historical volatility in fixed income, making it harder to unload the underlying bonds. As a result, the ETFs are trading at persistent discounts as thin liquidity sidelines market makers.

"If the authorized participants felt that they could buy an ETF at a 15% discount and then turn around and sell those components to the cash market 15% higher, they would," said David Schawel, chief investment officer at Family Management Corp. "But clearly they feel like there's not enough activity in the cash market, therefore they can't do that."

The carnage is notable across the risk spectrum. A combined $14.4 billion exited from investment credit, high yield and leveraged loan funds this week, the largest withdrawal on record. And even Treasuries — regarded as the ultimate safe haven asset — have suffered this week as investors sold their most liquid securities in order to raise cash.

The stress in fixed-income ETFs is a stark contrast to the landscape in equities, where the sell-off has been rather orderly. The price of the $227 billion SPDR S&P 500 ETF Trust — the largest ETF — dropped just 0.13% below its net-asset value on March 12. The second-biggest ETF, the $164 billion iShares Core S&P 500 fund, ended Thursday with just a 0.14% discount.

And the cracks are widening. The $3.6 billion VanEck Vectors High Yield Municipal Index fund's price fell a record 19% below its net-asset value on Thursday, the largest discount in the $4.4 trillion ETF market. And even the early success stories are starting to feel the strain. The iShares iBoxx High Yield Corporate Bond ETF's price has dropped over 1% below its net-asset value, after ending Monday with a modest half a percentage point discount amid its worst day since 2009.

Some are spying opportunity as fixed-income ETFs become further ensnared in the bond market's liquidity crunch. The rapid plunge in prices creates a "unique" entry point for funds trading at a discount, according to Schawel, who pointed to investment-grade corporate bond ETFs as an example.

"There's a leap of faith if you think that you're buying a discount because the cash markets aren't functioning very well," Schawel said. "If these are assets that you're wanting to own anyway, then I think it's a very unique opportunity to buy things at an even greater discount."

Bloomberg Markets

By Katherine Greifeld

March 13, 2020, 9:34 AM PDT

High-Yield ETF Rout Widens Gap With Benchmarks.

The structure of credit funds at least partially exacerbated the losses and volatility.

A rush to the exits has always raised fears of a liquidity mismatch.

Ever since the introduction of exchange-traded funds tracking the riskiest bonds, they've been haunted by fears of a liquidity mismatch with the underlying securities when investors stampede toward the exit. And yet, time and again, those concerns have proved to be unfounded.

During the sell-off in risk assets in December 2018, for instance, the largest ETF tracking junk bonds suffered losses but in an orderly fashion, never stumbling by more than 0.9% in a single day. Even in the past two weeks, the iShares iBoxx High Yield Corporate Bond ETF (ticker HYG) took the market volatility largely in stride. So did the Invesco Senior Loan ETF (ticker BKLN) and the VanEck Vectors High Yield Municipal Index ETF (ticker HYD), which respectively are the largest ETFs tracking the leveraged-loan market and speculative-grade munis. Sure, they declined, but never to an extent that raised eyebrows about the ETF structure itself.

Then Monday happened.

HYG collapsed as much as 6.4%, the most extreme decline since May 2010. BLKN plunged as much as 7.8% in the biggest intraday decline since inception in March 2011. And HYD crumbled as much as 6.1% in the steepest drop since August 2011, just after S&P Global Ratings downgraded the U.S.

Of course, those moves didn't exactly come out of nowhere. The S&P 500 Index tumbled 7.6% and equities worldwide plummeted in what was nothing short of carnage for global financial markets. But a look at the benchmark indexes tracked by the ETFs suggest that the structure at least partially exacerbated the losses and volatility.

The S&P/LSTA Leveraged Loan 100 Index, for instance, fell 2.84% on Monday in the largest one-day percentage drop since November 2008. But that was still less than the 3.09% decline at the close for BKLN and pales in comparison to the ETF's intraday low. Similarly, the Bloomberg Barclays U.S. Corporate High Yield Index fell just 3.12%, and the iBoxx USD Liquid High Yield Index just 3.62%, both short of HYG's 4.3% retreat. And in the biggest deviation from expectations, the Bloomberg Barclays muni high-yield index that HYD tracks fell just 0.86%, compared with HYD's 5.1% plunge.

To be fair, many funds will have some margin of tracking error with their benchmarks, especially during volatile trading days. The $77.8 billion iShares Core U.S. Aggregate Bond ETF, ticker AGG, had some trouble, for instance — its price fell 0.13% compared with a 0.35% gain for the Bloomberg Barclays index it tracks. And the SPDR S&P 500 ETF Trust dropped 7.81% while the S&P 500 itself declined just 7.6%. Those are small enough differences to even out over the course of a few trading sessions.

It's harder to explain away the deviation among the high-yield ETFs. Speculative-grade muni bonds, in particular, are notoriously idiosyncratic and difficult to move in bulk during turbulent market conditions. When trading is calm, the bonds glide higher. And so does the ETF: In 28 of the first 34 trading days of 2020, HYD and its index moved within 10 basis points of each other. On days like Monday, 10 months of price appreciation can disappear within six-and-a-half hours as market makers slash prices on low-rated health-care systems and senior-living facilities.

The high-yield corporate bond ETF has had several days like Monday in which its losses exceeded its benchmark, or vice versa. But it, too, tends to project steadiness during boom times. From Oct. 3 through Jan. 24, a period marked by steady positive returns, the ETF deviated only once from the underlying index to the extent it did on Monday.

Whether the sell-off continues unabated is an open question. U.S. equity futures soared in overnight trading Tuesday on bets that fiscal stimulus would stave off the worst-case economic scenario from the coronavirus outbreak, and the S&P 500 was up 3 percent in early trading. Each of the ETFs tracking risky debt opened higher. Crucially, global primary markets began showing signs of life for some bond issuers. These are hardly favorable conditions for the riskiest corporate borrowers, with high-yield spreads the widest in four years and double what they were just two months ago, but at least there's a hint of an opening on the horizon.

Buyers of high-yield ETFs will just have to accept that there will be days like Monday. The funds have demonstrated that they're not going to blow up spectacularly like H2O Asset Management or Woodford Investment Management. But there might still be some fireworks along the way.

Bloomberg Opinion

By Brian Chappatta

March 10, 2020, 7:43 AM PD

KBRA Releases Research – Coronavirus (COVID-19) Impacts and Fears: A Focus on U.S. Airport Credit

Kroll Bond Rating Agency (KBRA) releases a research report discussing the growing coronavirus threat and the impact that it may have at U.S. airports.

Over the last week, it has become clear that the new coronavirus' impact will not be limited to distant parts of the world. As confirmed cases of coronavirus infection and deaths increase, U.S. businesses, schools, and families have begun to significantly curtail travel. In the short run, at least, this will impact hotels, airlines, and other travel-related industries. Meanwhile, the myriad secondary effects from supply chain and other economic disruptions has led most economists to believe there is at least a 50% chance of a U.S. recession in late 2020. For the Public Finance market, KBRA notes that all these issues will likely have the most immediate impact on economically sensitive taxes (e.g., sales tax) and on passenger traffic at airports. The extent of this impact will depend on the spread of the disease, the local and federal response to containment, and the public's confidence in those efforts.

In this report, we examine the impact that the COVID-19 threat may have on U.S. airports and the layers of protection that airports typically have available to them against disruptions in air traffic and related revenues. KBRA believes that airport impacts will vary, but our expectations are that strong cost recovery processes will support debt obligation repayment.

To access the report, click here.

Business Wire

March 5, 2020

S&P: COVID-19's Potential Effects In U.S. Public Finance Vary By Sector

With the COVID-19 outbreak having spread to 40 countries around the world including the U.S., S&P Global Ratings has updated its narrative on the economic and credit implications (see "COVID-

19’s Darkening Shadow”). Given that update, in this report we provide insight on what we will be watching in regard to credit conditions in U.S. public finance. (Also see “U.S. Public Finance 2020 Sector Outlooks Published,” published Jan. 16, 2020 on RatingsDirect.)

Key Takeaways

- The growth forecast for the U.S. economy has been reduced as a result of the spread of the virus across the globe and we have seen record volatility in the equity markets. These are not welcome developments for U.S. public finance issuers.
- The economic fallout from the coronavirus has become more acute and there are sector-specific issues that could weigh on credit quality.
- The spread and timing in the U.S. and how it is managed will ultimately determine the credit implications across U.S. public finance.

[Continue reading.]

[Muni-Bond Buyers Get a Coronavirus Warning in California Sale.]

- **An economic crimp caused by virus could stunt budget**
- **State about to sell $2.2 billion of general-obligation bonds**

It didn’t take long for an issuer in the $3.8 trillion municipal-bond market to warn investors that the coronavirus rapidly spreading around the globe has the potential to wreak fiscal havoc closer to home.

California, the home of the world’s fifth largest economy, told prospective buyers of the $2.2 billion of general-obligation bonds that will be sold next week that a stock-market decline or a virus-triggered recession have the potential to stunt California’s revenue.

“There can be no assurances that the spread of a novel strain of coronavirus called COVID-19 will not materially impact the state and national economies and, accordingly, materially adversely impact the general fund,” California said in offering documents circulated to investors ahead of the bond sale. “While the effects of COVID-19 on the state may be temporary, it appears to be altering the behavior of businesses and people in a manner that may have negative impacts on global and local economies.”

California’s warning comes as governments globally are trying to come to grips with the virus before the world economy tips into recession. The concerns sent the Dow falling 12% last week, including the single biggest point drop in history. Yields on top-rated U.S. state and local debt maturing in 30 years fell about 18 points last week, the biggest drop since September 2013, as investors plowed into safe havens like bonds sold by California.

While California has enjoyed a robust recovery from the recession, with credit ratings the highest in nearly 20 years and unemployment at a record low, it is vulnerable to market declines because of its reliance on the wealthy for a significant chunk of its tax revenue.

About 70% of the state’s general fund comes from personal income-tax receipts and the top 1% of taxpayers accounted for 47% of such collections in 2017, the bond documents say. Such people have their fortunes tied to the stock market, with capital gains accounting for about 10% of the state’s annual revenue this year. That leads to volatility generally, and “stock markets in the U.S. and globally have seen significant recent declines that have been attributed to coronavirus concerns," California said in the documents.

The state, where about 40 people are being treated for the illness, told investors that while the impact is "currently uncertain," it may factor into Governor Gavin Newsom's updated budget for the next fiscal year to be released in May.

Despite the state's warning, the bond sale will likely see strong demand from buyers, given the continuing need to invest and shelter income from taxes, said Dora Lee, vice president at Belle Haven Investments.

California 10-year general-obligations are yielding just 7 basis points over top-rated bonds and new securities from the state have been snapped up since the federal tax overhaul capped state and local tax deductions.

Newsom's administration expects to have $18 billion in the state's rainy day fund next year, from $16 billion this year, and that could cushion the state somewhat from a recession.

California "is in a better position financially to handle the outbreak than it was even a few years before," Lee said.

Bloomberg Markets

By Romy Varghese

March 2, 2020, 10:43 AM PST

Muni Bonds Are Menaced by the Coronavirus Spread (Podcast).

Hospital and transportation muni bonds could be hurt by the spread of the coronavirus, says Kathleen McNamara, senior municipal bond strategist at UBS Global Wealth Management. Bloomberg News reporter Amanda Albright and columnist Joe Mysak weigh the outlook. Plus, an ambitious West Virginia project makes a bond-market return.

Play Episode

Bloomberg

March 5, 2020 — 10:07 AM PST

S&P U.S. Municipal Sustainable Debt And Resilience 2020 Outlook: Sprouting More Leaves

Table of Contents

- Other Impact Labels: Sustainability Bonds, Social Bonds, And Beyond
- External Verification Is On The Rise–Will Additional Disclosure Follow?
- Will Rising Discussion Of Resilience And Adaptation Spur Growth In This Nascent Niche Of The Green Bond Market?
- Why Does Adaptation Remain A Small Part Of The Labeled Bond Market?
- Recent Proposals To Increase Investment In Adaptation And Resilience
- Though Well-Suited For Adaptation Finance, Persistent Challenges Will Impede Rapid Market Segment Growth
- Trends To Watch In Municipal Adaptation Finance

Key Takeaways

- U.S. municipal self-labeled green bond issuance had its strongest year yet in 2019, with 99 issues totaling $10.1 billion in issuance, or 2.4% of the total municipal market.
- Based on recent trends, we project 2020 municipal green issuance of $11.4 billion to $14.0 billion in 2020, with a most likely amount of $13.2 billion.
- Municipal issuers are also issuing debt carrying other labels intended to highlight a financing's environmental, social, and governance (ESG) credentials, most notably sustainability bonds ($2.8 billion in 2019) and social bonds ($621 million).
- For the first time, in 2019, the majority of municipal green bonds had external verification, and 23% of sustainability bonds were Climate Bond Certified.
- Resilience continues to emerge in budgets and capital plans as a focus area for municipal governments, although challenges remain to financing large-scale resilience and adaptation projects.
- Debt financing of adaptation projects remains a largely undeveloped portion of the green bond market, and a mostly untapped portion of the broader municipal market.

Continue reading.

For Growing Numbers of Struggling U.S. Cities, the Downturn Has Arrived.

A boom in some big metropolitan areas has masked fiscal weakness in cities tied to shrinking industries

HARVEY, Ill.—Christopher Clark was elected mayor last year, pledging to seek business tax reductions and lower water bills. They were popular goals that seemed in reach given that city revenues had been rising almost every year since the recession.

On taking office, Mr. Clark quickly figured out the city's progress had stalled. Property tax collections were down, and businesses were cutting jobs. A fall in city revenue, coupled with growing debt payments, meant there would be no relief from business taxes or water bills.

"We just have to figure out ways to do more with less," Mr. Clark said, echoing a familiar mantra surfacing in dozens of U.S. cities.

A decade of growth in the U.S. economy allowed cities to patch fiscal holes left by the financial crisis and recession. A surprising number now see new signs of trouble.

Continue reading.

The Wall Street Journal

by Heather Gillers

March 3, 2020 10:16 am ET

Fitch Ratings Releases Final U.S. Affordable Housing Rating Criteria.

Link to Fitch Ratings' Report(s): U.S. Affordable Housing Rating Criteria

Fitch Ratings-New York-05 March 2020: Fitch Ratings has released its 'U.S. Affordable Housing Rating Criteria' following market consultation on the exposure draft published on Dec. 5, 2019. Fitch has concurrently released a Special Report titled 'Feedback Report – Comments on Exposure Draft: U.S. Affordable Housing Rating Criteria', which summarizes the written and verbal responses received during the exposure draft period and Fitch's responses to the feedback.

As a result of market input, the final criteria report incorporates the following key changes:

–A more explicit methodology for rating affordable housing bonds with Low Income Housing Tax Credit (LIHTC) equity.
–Added clarity on Fitch's analytical approach to evaluating debt service reserve funds in affordable housing transactions.
–Recognition of the potential for senior and subordinate bonds and clarification on Fitch's approach to rating a multi-tranche structure.

No additional changes were made to the proposed exposure draft. As Fitch does not currently maintain ratings under the criteria, there is no rating impact resulting from the changes.

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The Airline Industry's Virus Woes Seep Into a Bond Market Haven.

- **Investors demanding higher yields on airline-backed muni bonds**
- **Bloomberg Barclays index has slipped this week amid pullback**

Even one of the world's safest financial havens isn't totally immune from the coronavirus.

Investors have been demanding bigger yields on state and local government bonds backed by U.S. airline companies, which are already showing signs of being hurt by a slowdown in travel brought on by the widening outbreak. The Bloomberg Barclays index of lower-rated municipal debt tied to airlines — including those secured by lease payments they make on airport terminals — has slid for the past three days, driving it to a loss of 0.88% this month, nearly triple that of the broader municipal junk-bond market.

"It might just be prudent to be cautious on airports in the short-term," said Peter Stettler, a director for Piper Sandler, an underwriter and investment management firm.

The growing number of cases worldwide and in the U.S. has prompted businesses and vacationers to scale back their travel plans. United Airlines Holdings Inc. and JetBlue Airways Corp. are cutting their number of flights and Southwest Airlines Co. said it expects the epidemic to reduce its first-quarter revenue. The International Air Transport Association Thursday projected the impact of the coronavirus will cost the airline industry $63 billion to $113 billion in lost revenue this year, up from an estimate for a $30 billion loss just two weeks ago.

United Airlines-backed debt issued by the California Municipal Finance Authority that financed a new aircraft maintenance and ground services complex at Los Angeles International Airport traded Thursday at a yield of 2.17%, or about 1.3 percentage points more than top-rated bonds with the same maturity. On Feb. 20 investors demanded a 0.7 percentage point premium.

American Airlines-backed bonds issued in 2016 by a New York agency related to the construction of its terminal at New York's John F. Kennedy International Airport traded at yield of 2%, about 0.8 percentage point more than where Bloomberg Valuation pegged that spread on Feb. 28.

It's impossible to judge whether the virus will have a long-term impact, given the lack of certainty about how much it will spread and how severely it affects economic growth. But Piper Sandler has recommended that investors pare their exposure to airports for the short term, especially given how high prices ran up amid the market's rally over the past few years.

"We expect that to continue but over the next couple of months as this plays out we might see a decline in passenger volume," Stettler said. "It's a short-term cautionary play."

Bloomberg Markets

By Shruti Singh and Martin Z Braun

March 5, 2020, 11:02 AM PST

S&P U.S. Higher Education Rating Actions, 2019.

S&P Global Ratings affirmed 88% of college and university ratings reviewed in 2019. We lowered 17 ratings and raised 14. Notably, of the schools upgraded, three are rated in the speculative grade category (Western Illinois University, Eastern Illinois University, and Sweet Briar College), and three moved from one rating category to another: Boston University, Villanova University, and the University of Alabama Huntsville were all upgraded to 'AA-' from 'A+', due to strengthening credit profiles, exemplifying the intensifying bifurcation within the sector. Additionally, the sector saw over twice as many negative outlook revisions (20) as it did positive outlook revisions (7).

[Continue reading.](#)

[Advancing Municipal Bonds and Infrastructure: BDA Co-Hosts Infrastructure Roundtable on Capitol Hill with Public Finance Network.](#)

Yesterday (March 3, 2020), the BDA along with the Government Finance Officers Association, National Association of Counties, American Public Power Association and BDA member firm Hilltop Securities hosted a roundtable on Capitol Hill titled, ***Muni Bonds 101: Modernizing Infrastructure into the 21st Century***.

The event was kicked off by an introduction from Congressman Steve Stivers (R-OH), the Co-Chair of the House Municipal Finance Caucus, and attracted a standing room only crowd of Hill staff and industry participants and focused on top BDA infrastructure priorities:

- Continued support and protection of the tax-exemption;
- The reinstatement of tax-exempt advance refundings;
- Raising the limit on BQ debt;
- The expansion of PABs; and
- Working to ensure that BABs, if reinstated, would be uncoupled from sequestration.

The panel was moderated by Anne Burger Entrekin, Hilltop Securities Regional Managing Director and featured:

- Kendel Taylor, Finance Director, City of Alexandria, VA (GFOA)
- Commissioner Kevin Boyce, Franklin County (OH) (NACo)
- Jolene Thompson, Executive Vice President of Member Services and External Affairs, American Municipal Power (APPA)

Bond Dealers of America

March 4, 2020

[Blockchain: Are Munis Next?](#)

If municipal bonds could talk, they might tell you which town they came from, what specifically they are funding, and who or what backs them. Have a longer conversation and they might share where they have recently traded, how valued they are by others and perhaps more intimate disclosures.

That conversation could provide in an instant the reference data such as issuer, type of bond, guarantor, trading counterparties, transaction prices, and disclosures that you would normally have to pay for today.

Chit chatting with municipal securities may not be practical, however, there are a handful of bonds designed by prominent market participants capable of placing themselves at issuance, paying their own coupon and principal to bondholders, and enabling trading on or off exchanges.

And in the municipal market where the volumes are huge, sizes often small, and details opaque, the cheapest way to get all of this done may just be to turn bonds into computer programs that can facilitate issuance, exercise options, and feed data to market participants.

No servicers, registrars, custodians, or evaluators — just bonds and you.

Sound far-fetched? Not for the likes of The World Bank, Daimler Chrysler and a handful of others who have issued bonds with some of these traits using the latest “smart contracts” and blockchain technology has to offer. And a number of FinTech firms are creating blockchain-based solutions that are already able to deliver capabilities like this to savvy issuers, investors, and investment banks.

It is easy to see why issuers like The World Bank would want to experiment. With their own annual debt issuance of $54 billion in 2019, the ability to reduce issuance and maintenance costs would be significant and could be applied to further their mission. Some estimate the total savings could top 75% of associated issuance fees with the time to market reduced by as much. But the savings exist for smaller issuers like school districts, municipalities, and local projects as well since these issuances incur many of the same costs as larger deals but don’t scale as well.

The World Bank issued two “bond-i” deals leveraging blockchain and smart contract technology. The first of the two bonds was the AUD 100 million 2.2s of 8/2020 issued in August 2018 that was led by Commonwealth Bank of Australia (CBAUF). The purpose of this issue was to test how a bond could be created, sold, and settled using blockchain technology. Then in May of 2019, The World Bank issued an additional AUD 50 million deal led by Commonwealth Bank of Australia (CBAUF), RBC Capital Markets and TD Securities to demonstrate secondary trading using blockchain (aka distributed ledger technology).

But what does it mean to issue a bond “on the blockchain” or have a bond issued as a “smart contract”? A blockchain is a digital ledger shared by a group of participants such as issuers, investors, regulators, etc. When a bond is sold, the owner of the security is automatically recorded on the ledger and future changes in ownership are recorded as additional entries on the ledger. Any traditional participants that are involved in recording ownership or processing a transfer of ownership such as custodians, registrars, and transfer agents, would technically no longer be required.

Separately, “smart contracts” are computer programs that automate legal contracts. When a bond is issued as a smart contract, we are saying that the bond indenture is constructed as a computer program instead of or in addition to the document. Since the program can identify the party that owns the bond as recorded on the blockchain the program can also automatically process the payment of coupons and principal payments or send out information on corporate actions such as call notices. This reduces the need for traditional parties to a transaction such as servicers.

In a market where all records of an outstanding bond are shared in the same place it is easier to link supporting information and disclosures such as the information that we search for on the MSRB’s Electronic Municipal Market Access (EMMA) today. Parties such as rating agencies will obtain the required information for the assignment and surveillance of ratings more efficiently as well as speed the distribution of those ratings. And since these ledgers record all entries forever all market participants can look back to see what was done and what data was available at any point in time.

The precise impact on the municipal market is difficult to predict but there are definitely going to be more efficient days ahead. And we don't need the entire vision to come true to reap the rewards. Some FinTech firms are focusing on certain aspects of the lifecycle of a security such as the negotiation of contracts; Know-Your-Customer procedures; issuance and secondary trading; linking reference data to securities, and still others on custody and servicing. As well, the experiments are covering all the asset classes we know today in traditional markets such as equity, bonds, loans, funds, derivatives, structured finance, and the like.

Technologists are ready to deliver more efficient financial instruments, but market participants need to acquire more of an appetite for innovation. Significant savings on issuance fees, debt maintenance, and retirement will go to those that get involved the earliest. Once issuers understand that this technology changes the balance of power in the capital markets in their favor things will move quicker.

Treasurers can get up to speed easily enough by contacting advisors that specialize in this space or directly reaching out to FinTech firms that are building solutions before they reach out to their financial advisors when planning their next issuance. Procrastinating will inevitably lead to taxpayers hearing about the savings achieved from the "talking muni bond" in a rival state.

By Andrew Pedvis

BY SOURCEMEDIA | MUNICIPAL | 03/02/20 12:45 PM EST

U.S. Rep. Danny Davis Co-Sponsors MAMBA.

The Modernizing Agricultural and Manufacturing Bonds Act (MAMBA) is a common-sense, bipartisan, targeted reform package that will modernize two categories of qualified small issue private activity bonds: Small Issue Manufacturing Bonds (more commonly known as Industrial Development Bonds (IDBs)), and First-Time Farmer Bonds (also called Agricultural Bonds, or simply Aggie Bonds). These types of bonds are key economic development tools used by state and local agencies to finance the small- to mid-sized manufacturing and agricultural sectors.

Unfortunately, IDBs and Aggie Bonds have not been modernized in over 30 years, causing stagnation and decline in these respective industries. Over the past decade, IDB and Aggie Bond issuances have substantially declined due in major part to the outdated rules and regulations that govern the use of these bonds. The six reforms contained within MAMBA will update the Internal Revenue Code (IRC)'s private activity bond rules for IDBs and Aggie Bonds. The six reforms are as follows:

1. Expand the definition of "manufacturing facility"
2. Eliminate restrictions on "directly related and ancillary facilities"
3. Increase the maximum IDB size limitation from $10 million to $30 million
4. Increase the limitation on small issue bond proceeds for first-time farmers
5. Repeal the separate dollar limitation on the use of small issue bond proceeds for depreciable property
6. Modify the definition of "substantial farmland"

Read the CDFA Press Release

View the text of H.R. 5422

A Rise in the Taxable Municipal Debt Issuances.

For some investors, the sole purpose of investing in municipal debt is to take advantage of the tax-free income, diversified portfolio and limited risk exposure that is often higher in the world of corporate debt than municipal debt.

These ideas and advantages of municipal debt may not be wide-spread or applicable to every investor equally – for example, the tax-free benefit can vary from investor to investor depending on their income tax brackets, and for some investors taxable investment instruments may present more of a lucrative option than municipal debt.

Furthermore, when municipalities issue taxable debt, it's either for a purpose/project that may not allow them to issue tax-free debt to raise capital. Taxable municipal debt issuance makes sense, at a given particular time, after gauging an investor's interest and appetite. Historically, taxable municipal debt issuance has been close to 10% of the entire tax-exempt municipal debt. For instance, in 2018, the taxable debt issuance was $25.1 billion dollars, whereas the tax-exempt debt was roughly $278.1 billion. However, 2019 was record-breaking for taxable municipal debt issuance.

In this article, we will take a closer look at the world of taxable municipal debt and how it fits into your portfolio.

Continue reading.

municipalbonds.com

by Jayden Sangha

Mar 04, 2020

Muni-Bond Yields Jump Over Treasuries for First Time Since 2016.

- **10-year benchmark tax-free debt yields more than Treasuries**
- **'Munis have hit this wall — they just can't go much further'**

Treasuries have rallied so hard that they're breaking their usual link with municipal bonds.

The yield on 10-year Treasuries tumbled 14 basis points Thursday to about 0.92%, pushing it below those on top-rated tax-exempt debt for the first time since late 2016, according to data compiled by Bloomberg. Thirty-year state and local government bonds are yielding 1.54%, roughly the same as Treasuries despite the tax break that usually leaves investors willing to accept far lower payouts.

Those ratios — a closely watched gauge of relative value — show how much the concern about the toll of the coronavirus has upended the dynamic in the bond market. As recently as mid-January, municipal bonds were trading at near record high prices when compared with Treasuries as cash flooded in and governments didn't sell debt fast enough to keep up. But that has shifted dramatically this week, as Treasuries kept rallying and municipal debt held relatively steady — in part because absolute yields may have tumbled so much that the individual investors who are the major buyers may be resisting.

“Munis have hit this wall –- they just can’t go much further because it’s a retail dominated market,” said Nisha Patel, a director of portfolio management at Parametric Portfolio Associates who shifted out of munis in January but is now wading back in. “Given the ratio level we would rather be in munis than Treasuries because munis are so much cheaper right now.”

Bloomberg Markets

By William Selway and Danielle Moran

March 5, 2020, 10:37 AM PST

[Muni Trading Drops to Lowest Since 2006, Showing Industry Shift.]

- **Number of municipal transactions sank 14% in a year’s time**
- **Small-sized trades fell while institutional activity increased**

Mom and pop look like they’re starting to leave municipal-bond trading to the professionals.

Last year saw trading sink by 14% to the lowest level since 2006, or 8.75 million transactions, according to a Municipal Securities Rulemaking Board report on Tuesday. The drop was driven by fewer trades of $100,000 or less, signaling less activity by retail investors, the report found.

The decline in retail buying and selling could be explained by the movement toward professional management of municipal bonds. Separately-managed accounts have become an especially popular area for retail investors who want to tailor their investments to their needs.

[Continue reading.]

Bloomberg Markets

By Amanda Albright and Mallika Mitra

March 3, 2020, 10:57 AM PST

[Muni Bonds Now Yield Next to Nothing, But Americans Keep Buying.]

- **Cash keeps flowing in as rally pushes prices to heady levels**
- **Yields in secondary market driven by past gains, havens**

In theory, the swiftly disappearing yields on municipal bonds should be deterring the little buyers like Greg Fazakerley who dominate the $3.8 trillion market.

That’s not happening in practice. Even before the coronavirus set off a stampede into financial havens, American state and local government debt prices had pushed past the levels once seen as triggers for an investor revolt. The latest panic has given the market a further jolt, with about $2.3 billion sent to municipal-securities mutual funds last week even as benchmark yields breached the psychological threshold of 1%.

“Taking a look at the monthly statement in municipals, your manager is talking about basis points,” said Fazakerley, a 72-year-old real-estate developer who is continuing to buy municipal securities. “We kind of chuckle over a cup of coffee. That’s not where we’re squeezing the lemon to get more juice.”

Americans who already held about $1.9 trillion of state and local debt poured another $113 billion into mutual funds focused on the securities since early 2019, according to Investment Company Institute and Federal Reserve figures. That stepped up buying came even as prices hit new highs relative to Treasuries, yields slid toward more than 60-year lows and fixtures tailored to such buyers — like 5% coupons — were jettisoned, leaving some money managers questioning what threshold, if any, will cause individual investors to retreat.

Nicholos Venditti, a portfolio manager for mutual fund company Thornburg Investment Management, said it’s difficult to currently make the case for buying municipal debt. He said one client gave push-back on a 10-year bond he bought that yielded just under 1.4%.

“If enough people scratch their heads and ask that question, that’s where you start to see a little bit of a break in the asset class,” he said.

The fidelity can be explained by the steady returns the securities have delivered as prices continue to rise, causing buyers to keep stepping up their investments. Overall, municipal securities haven’t lost money since 2013 and last year returned 7.5%, the biggest gain since 2014. Citigroup Inc. analysts said the market has benefited from a self-reinforcing cycle, with positive returns drawing in more cash from individuals.

Starting in early 2018, the demand was increased by the cap President Donald Trump placed on state and local tax deductions. As a consequence, many Americans began using tax-exempt securities as an alternative way to drive down what they owe. The demand received an additional spur this year from a flight-to-quality movement in markets given that defaults by state and local governments were extremely rare even during the last recession. That has driven the yield on 10-year benchmark bonds to about 0.94%, less than one-third of what it was in 2013.

J.R. Rieger, who invests in municipals and runs a blog about bond investing called the Rieger Report, said the securities make sense as a risk-off trade. “The problem is you’re not going to earn any yield at all,” he said.

Nevertheless, buyers haven’t been turned off yet. Los Angeles International Airport, rated AA, last week borrowed at below AAA yields, with bonds maturing in 2021 yielding just 0.63%. Even risky debt is paying only what top-rated securities once did. An Ohio agency sold a massive tobacco-settlement bond sale with unrated debt due in 2055 trading at an average of 3.4% yields on Friday.

Lewis Appelbaum, a retiree who invests in municipal bonds, said he’s not worried about the sub-1% yields. He estimates he has about 30% of his assets in municipals.

“It’s certainly unattractive, but where would you go?” he said. “Where would you put your money that’s going to be more attractive?”

Retail investors are notoriously bad at timing the market and often move like a herd, plowing in money when the market is going up and pulling back when it falls.

Debra Taylor, who advises high net-worth individuals at Taylor Financial Group in New Jersey, said she isn’t a “fan” of the municipal market given where yields are, but they still make sense for clients who don’t have the right temperament for risk.

Even a 30% or 40% allocation to municipals can make sense for some. "Part of it is a factor of what the alternatives are — not that munis are this incredible, screaming opportunity," she said.

Bloomberg Markets

By Amanda Albright

March 2, 2020, 8:17 AM PST

Wells Fargo Asset Management Launches Municipal Sustainability Fund.

WFAM extends ESG capabilities with new framework for assessing U.S. municipal bonds

Wells Fargo Asset Management (WFAM) today announced the launch of the Wells Fargo Municipal Sustainability Fund, highlighting WFAM's commitment to provide clients innovative solutions and play a leading role in sustainable investing.

The Municipal Sustainability Fund utilizes a municipal bond assessment framework that WFAM developed in-house through the WFAM ESG Impact Framework, a partnership involving municipal bond professionals and Environmental, Social and Governance (ESG) professionals. The fund invests in securities that are assessed to have positive environmental or social impact at the bond or issuer level. The investment process also includes a top-down macroeconomic assessment and a bottom-up fundamental security analysis.

The fund is managed by WFAM's Municipal Fixed Income team, a 28-member investment team with a long track record in national and specialty state municipal bond portfolios.

"We are proud to launch the Municipal Sustainability Fund and to assist our clients in their search for returns and sustainable investment options," said Nico Marais, CEO of WFAM. "We are committed to being a leading player in sustainable investing, and this fund offers a great combination of our investment expertise and ESG capabilities."

Hannah Skeates, global head of Sustainable Investing at WFAM, said, "It's important for us to play a role in building the new constructs that the industry requires for robust sustainable investing. The WFAM ESG Impact Framework is the result of detailed work to take respected global principles and develop a process for applying those principles to individual municipal securities. We are excited to help lead the way in the evolution of this important area of investing."

The fund is managed by Wendy Casetta, Terry Goode and Robert Miller, veteran senior portfolio managers with the WFAM Municipal Fixed Income team. The Municipal Fixed Income team manages $40 billion (as of December 31, 2019) across 16 strategies. On average, the team has 22 years of industry experience and 11 years with the WFAM team.

For more information on the Municipal Sustainability Fund, please visit WFAM.com.

About WFAM Sustainable Investing

WFAM's dedicated Sustainable Investing team is made up of experienced ESG professionals who provide a holistic vision for the firm and partner on ESG and sustainability initiatives, including:

- Supporting the development of methodologies for integrating material ESG risk assessment into

ongoing investment analysis and portfolio management.
- Assessing the investment implications of climate change and the design of portfolio decarbonization strategies.
- Developing frameworks to help allocate capital to positive and impactful sustainability outcomes.
- Providing firm-level stewardship, with strategic and tactical company engagement.

Business Wire

March 4, 2020

Municipal Bond Funds: The Involuntary Move Toward Risk

Summary

- Municipal bond fund inflows in 2019 were tremendous. In fact, they set an annual record of $105 billion through Dec. 31 into open-end mutual funds and exchange traded funds.
- For perspective, we measured the three largest funds which are currently active and held over $1+ billion in assets in 2008. These funds averaged approximately 57% exposure to NR issues, while the peer average held 30%.
- Reviewing our current landscape, when considering the same search criteria as above, average non-rated exposure grew by 23% since December 2015-flirting with levels similar to 2008.

Continue reading.

Seeking Alpha

Mar. 3, 2020

Can You Hear The Madness In The Municipal Bond Market?

Overpowering Demand; Yields Sink To 1950s Lows; No End In Sight—these are just some of the headlines coming from the municipal bond sector. Old timers, young timers and market timers have never seen such a continuous rush to buy municipal bonds. The ghost of Meredith Whitney's past is rolling over.

As bond manager and a municipal bond investor myself, the market is grotesquely overvalued. Can it get more overvalued? Of course. But for me, it's time to put on the brakes.

The most overvalued states are of course the most confiscatory states: California, New York, Hawaii, Oregon, Minnesota, New Jersey, Vermont, plus the District of Columbia. Their state tax rates can choke a perfectly healthy investor.

Continue reading.

Forbes

by Marilyn Cohen

Mar 2, 2020

[Why Taxable Bonds are a Muni Market Fixture, Not a Fad.]

AUSTIN — At 30% of issuance so far in 2020, taxable munis are here to stay and will continue to be a force in the municipal market unless tax law changes or rates rise dramatically.

Taxable issuance ballooned to about $70.5 billion in 2019, by far the highest level outside the two years Build America Bonds were sold, 2009 and 2010.

That amount represented nearly 18% of the muni market'stotal 2019 issuance.

Members of the taxable bond panel at The Bond Buyer's Texas Public Finance Conference this week were unanimous in saying taxable issuance totals will grow further and represent an even larger piece of the overall issuance pie in 2020 and beyond.

From a broadened buyer base that includes larger institutional and international investors, but extends to direct retail and separately managed accounts, taxable demand has dramatically changed the municipal market starting in the second half of 2019.

Tom Ryan, head of municipal bond valuations at Refinitiv, noted that instead of typical crossover buyers, the market now has "crossover issuers" because they can truly take advantage of both markets in this rate environment.

Dan Bingham, head of institutional markets at Build America Mutual, said the taxable issuance boom has attracted a much larger investor base, including a growing number of institutional and international buyers.

Bingham said that in the BABs era, the investor base was broadened but when the program expired, the market went back to very limited issuance of taxables.

"With that said, we are even seeing smaller issuers selling taxable deals," he said. "Ultimately, we are seeing a much healthier environment" for all issuers.

The prospect that smaller issuers can access direct retail and SMA accounts engaged with the yield pick-up that can be found in the taxable space, is compelling, he said.

"Larger deals, recognizable names, index eligible deals — you've got a lot of institutional accounts that are much more apt to participate in this market," Bingham said. "International accounts are participating in the municipal market to a level we haven't seen before."

Low absolute rates across the globe are helping.

As the percentage of taxable deals relative to the total market continues to expand, they are becoming easier to understand from an international investor perspective, given some of the protections that are provided in the offering documents.

Investors are "looking for anything they can pick up spread," Bingham said.

The supply/demand mismatch, tremendous cash coming into the market via tax-exempt mutual fund inflows and compressed spreads on the tax-exempt side of the market are leading to a perfect environment for issuers to take advantage of the taxable market, Patricia McGrorry, managing director at Ramirez & Co., said.

"Across the curve there are buyers for every credit and every credit spectrum," she said. There are definitely different buyers for those smaller deals and different liquidity requirements, but "there's always a spread for everything." While she said that smaller issuers might face some concessions for a taxable deal less than, say, $25 million, it depends on the market conditions, such as what other taxable deals are being priced on a given day among other factors.

And the traditional municipal 10-year call is making the leap into the taxable space.

Panelists noted that prior to the recent market conditions, investors would charge at least a 35 to 40 basis point premium on a taxable 10-year callable deal. Today, the cost of the call is about 18 to 22 basis points. "That has changed pretty meaningfully," Bingham said.

McGrorry said the investor perception has changed and that "if you build it, they will come." The 10-year call option that many taxable municipal deals use is less of a deterrent in the current market than a few years ago.

Investors are "going to have to buy it if they want to participate. The penalty is credit specific and name by name recognition, and the 10-year call penalty will be less.

Ryan noted that while the global demand is strong, it is "surprising to me that taxable investors aren't penalizing issuers more."

With that, Ryan said issuers could even test the market with a seven-year call. In this market, investors are thinking, "do I actually care about the call option?"

Having more optionality is better for issuers and they should "call their bankers."

Bingham noted there are three ways of dealing with the lack of exempt advanced refundings: access it through a forward-delivery deal, a taxable refunding, or waiting.

"The value of savings today are too strong to wait," he said.

Barbara League, partner at law firm Orrick, Herrington & Sutcliffe, noted that she is seeing more inquiries into different structures to take advantage of low rates. Aside from issuing taxable bonds to refund exempts, she is seeing more forward-delivery bonds, certain swap structures, tender rights.

"How can we recreate what we lost? The best way we can recreate is to bring back what we lost," but that does not seem to be a likely scenario, she said.

One area that the participants agreed was that taxable issuance has pressured the exempt market significantly but that threats to removing the exemption at the federal level should not be considered.

Shannon Albert, Senior Director, Treasury & Assistant Treasurer at San Antonio's municipal CPS Energy, said even outside of the current taxable environment, "there is always that risk."

As a utility that issues a lot of tax-exempt debt, she said market participants have an obligation to do "everything we can to educate our legislators" on the exemption. "We use taxable as a tool in our toolbox. We look at strategically to see what the most makes sense," and there are multiple considerations to how she plans her bonding program.

“Issuing taxable debt sometimes is a better choice for us,” however, the exemption is integral to her debt portfolio. The exemption provides significant savings over long periods of time and will cost communities largely if it were to be taken away.

“I feel like we have an obligation to give [lawmakers] a hard time,” she said.

By Lynne Funk

BY SOURCEMEDIA | MUNICIPAL | 02/27/20 03:01 PM EST

Parametric Insurance: An Emerging Tool for Financial Risk Management

Local governments have a duty to respond quickly and decisively to extreme events and provide continuity in critical public service through adverse circumstances. Reserves or “rainy day funds,” federal assistance, and indemnitybased insurance* programs are the primary tools governments have used to manage risk associated with events, such as natural disasters, recessions, etc., that have the potential to disrupt public services. In recent years, a type of insurance instrument called “parametric insurance” has generated interest in local governments in North America to help fulfill risk management needs that aren’t met by indemnity based insurance, federal assistance, or rainy day funds.

In this paper, we will review the most import things local governments need to know about parametric insurance, including:

- Why local governments might wish to consider parametric insurance.
- Who is using parametric insurance, including a review of the experiences with parametric of two U.S. local governments and one state government.
- How to explore the use of a parametric policy.
- A review of the advantages and disadvantages of parametric insurance.

Download Research Report

Government Finance Officers of America

Author: Shayne C. Kavanagh Elizabeth Fu

Year: 2020

Fitch Rtgs: Aging Populations Strain State Budgets, Pension Funding Varies

Link to Fitch Ratings’ Report(s): Demographic Trends and Pension Pressures (Aging Populations and Underfunded Pensions May Present Fiscal Challenges for States)

Fitch Ratings-New York-25 February 2020: The aging US population poses a range of challenges to state finances, including providing pensions for the swelling ranks of retired public workers. However, a state’s demographic profile does not necessarily determine its pension funding, Fitch Ratings says. States with weaker demographic profiles are likely to face slower revenue growth and expenditure pressures but some of these states have maintained an approach to pension funding that alleviates pension pressure.

The population profiles of pension systems are aging, with the number of retirees drawing benefits growing, even as the number of active workers lags behind. For many plans, the number of retirees now exceeds the number of active employees. As states see populations age, revenue growth prospects slow and demand for services climb the concurrent demand for higher pension contributions in order to address underfunding may limit fiscal flexibility.

Fitch’s report assesses these pension burdens and demographic trends and differentiates states based on their position relative to 50-state medians, highlighting examples that illustrate the nuances of states’ funding considerations and the importance of sustained policy actions in managing the trajectory of pension burdens over time.

States are categorized by their position above or below the median projected labor force growth of 0.12% annually over the 2017-2026 period as projected by the US Census, and the median pension burden, which Fitch defines as the ratio of state net pension liabilities adjusted to a standard 6% discount rate as a percentage of personal income. The median pension burden measured 3.1% in 2018. Quadrants created by this comparison indicate whether states are well placed to manage their pension obligations based on the size of the liability and their active population.

States with the twin challenges of weaker demographics and higher underfunded pensions are arguably more vulnerable to fiscal pressures over time. Dominated by those in the Northeast and Midwest, many of these states are aging faster than the median, with a rising share of the population aged 65 and older, and barely growing or even declining working age populations. Some states within this quadrant, however, have shown commitment to pension funding that has resulted in an improved funding status.

An equal number of states are in the relatively more favorable situation of having both stronger demographic trends and carrying relatively lower pension burdens. Fiscal vulnerabilities stemming from either demographic trends or pension contributions pressures are likely to be lower for states in this quadrant. Pensions are either well funded, or if not, represent a smaller burden relative to the state’s wealth base.

The remaining states in the other two quadrants either have solid demographic trends but higher pension burdens, or lower pension burdens, despite weaker demographic trends. While still vulnerable based on weakness that could hamper full pension funding, these states arguably retain more fiscal flexibility than those in the upper left quadrant.

Most governments have taken steps to shore up their pensions by shifting to more reasonable assumptions, increasing contributions to the actuarial level and cutting future benefits for new workers. These corrective actions have less of an effect in the context of maturing pension systems. The problem is magnified for states in which pensions are a material burden relative to the state’s resource base.

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Additional information is available on www.fitchratings.com. The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

Fitch Ratings: Updates Report for U.S. Public Finance Structured Finance Criteria

Link to Fitch Ratings' Report(s): U.S. Public Finance Structured Finance Rating Criteria

Fitch Ratings-New York-28 February 2020: Fitch Ratings has published the following updated report: "U.S. Public Finance Structured Finance Rating Criteria." This report updates the report entitled "U.S. Public Finance Structured Finance Rating Criteria" published on Feb. 15, 2019. The key elements of Fitch's public finance structured finance rating criteria remain consistent with those of its prior criteria report.

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New P3 Contract Form Promises to Better Allocate Risk.

Dive Brief:

- ConsenusDocs has released a new form of agreement that public agencies, contractors and other stakeholders can use for public-private partnership (P3) projects.
- At 17 pages, "ConsensusDocs 900 Standard Public-Private Partnership (P3) Agreement and General Conditions (Where the Basis of Payment is Milestone, Completion and Availability Payments)" gives participants a "fair, off-the-shelf" alternative to the massive and complicated P3 contracts now in use, according to ConsensusDocs, as it does not bury the imbalance of risk contained in many agreements.
- A more equitable standard form of agreement, said ConsensusDocs, should lower transactional costs for small and medium-sized projects as users try to create a fair agreement and evaluate their risk. The ConsensusDocs 900 agreement was developed with input from a coalition of industry groups including the Associated General Contractors of America, the Associated Builders and Contractors and the Construction Financial Management Association.

Dive Insight:

There has been more interest in P3s during the last decade, said Brian Perlberg, executive director and senior counsel at ConsensusDocs, probably more than one might think because a lot of the activity is with small and medium-sized projects at the state and local government level, not just with the multibillion-dollar projects that make the news.

And, Perlberg said the P3 will only become more prominent as the U.S. seeks to deliver new infrastructure under current budgetary constraints.

"However," he said, "the way P3 contracting is currently operating is broken. Companies are fleeing the market because of the unprofitable, unsustainable risk transfer that is occurring." Trying to manage the improper risk, Perlberg said, sometimes makes the P3 model too expensive for big projects, let alone smaller ones.

While ConsensusDocs 900 could be a good starting point in developing a P3 agreement, such contract templates should only be looked at as guides since all P3s are different and one size does not fit all,said attorney Keith Poliakoff, a partner in the Fort Lauderdale, Florida, office of Saul Ewing Arnstein & Lehr and co-chair of the firm's government relations practice group. For example, he said, ConsensusDocs 900 presumes that financing will include availability payments and use the design-build method of project delivery. "If either is incorrect," Poliakoff said, "the agreement would have to be modified."

"There are many important benefits of using the P3 delivery method for appropriate infrastructure projects —simplicity of the contract documents is not one of them," said attorney William Eliopoulos with Rutan & Tucker, which is headquartered in Costa Mesa, California. "Every P3 project is different." The ConsensusDocs 900 document, he said, omits and glosses over many important terms that should be included even in small to mid-sized projects.

For example, he said, an important benefit of the P3 model is that the concessionaire gives the public entity owner post-construction facility performance guarantees and agrees to financial penalties if they are not met. "This important benefit seems to be missing from the ConsensusDocs 900 project agreement," Eliopoulos said.

In addition, he said, one of the important advantages of the P3 delivery method is that it allows the public entity owner, concessionaire, design-build contractor and long-term operations and maintenance service provider to collaborate at the beginning of procurement and determine how best to structure the deal, including who is in the best position to price and control each of the project's major risks, how best to design it, build it, finance it and operate and maintain it. This seems to be missing from ConsensusDocs 900, Eliopoulos said.

The new form, Perlberg said, is not intended to be everything to everyone but rather a good starting point to help reset the conversation about what is fair and what is a reasonable risk allocation for all concerned, particularly for projects less than $100 million. "Part of the problem is there hasn't been anything on the marketplace to fulfill that need," he said.

Construction Dive

by Kim Slowey

Feb. 26, 2020

S&P Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors

Table of Contents

- ESG In U.S. Public Finance
- States And Local Governments
- Water And Sewer, Solid Waste, Public Power And Electric Cooperative Utilities
- Health Care
- Charter Schools
- Higher Education
- Transportation
- Related Research

Key Takeaways

- S&P Global Ratings has been incorporating environmental, social, and governance (ESG) risks and opportunities into the credit ratings of public finance entities based on factors embedded in our sector-based criteria.
- ESG credit factors can influence the capacity and willingness of an obligor to meet its financial commitments, but strong
- ESG credentials do not necessarily indicate strong creditworthiness.
- Our long-term ratings and ESG credit factor analysis incorporate qualitative and quantitative analysis and do not have a pre-determined time horizon.
- Challenges remain with respect to data and disclosure practices. However, we anticipate that over time, as the market evolves, disclosure from borrowers will converge and increase transparency on ESG factors.
- Even with additional data, ESG analysis will increasingly require a qualitative view of an entity's capacity to anticipate a variety of long-term plausible disruptions to its credit fundamentals as well as an assessment of management's capacity to preserve financial and organizational resiliency.

Continue reading.

S&P: Will The Expiration Of LIBOR Affect The Credit Quality Of U.S. Public Finance Issuers?

Table of Contents

Key Takeaways

- The London Interbank Offered Rate (LIBOR) is set to expire in December 2021.
- We continue to assess the financial exposure U.S. public finance (USPF) issuers face due to financing and hedging transactions tied to LIBOR
- We believe the low notional amount of LIBOR exposure relative to overall debt portfolios should limit the extent of financial pressures and credit implications for USPF issuers.

Continue reading.

S&P: U.S. Public Finance Issuers Must Be Nimble To Fend Off Cyberattacks Or They Could Face Credit Fallout

Table of Contents

Key Takeaways

- Cyberattacks, like any event risk, can pressure liquidity and operational balance, and can further create contingent liabilities for U.S. public finance (USPF) issuers.
- Social engineering attacks, which consist mainly of phishing and pretexting, attempt to trick users into helping attackers evade security controls, which can open the door for them to carry out ransomware infections, invoice fraud, and other attacks that can cost substantial amounts of money.
- Wider availability of more complex exploit kits (malicious software kits) increases the likelihood of breaches, necessitating better issuer preparedness.
- As threats evolve, so do prevention efforts, including a growing trend of state-level support for improving local government cyber defenses.

Continue reading.

S&P: Environmental, Social, And Governance: Increasing Generational Dependency Poses Long-Term Social Risks To U.S. States' Fiscal And Economic Stability

Table of Contents

Key Takeaways

- Budgets in the Northeast will likely be pressured by increased Medicaid costs as aged enrollment (65 and older) grows.
- While the South has benefited from an influx of working-age adults, continued economic diversification is crucial to credit stability.
- We expect significant out-migration and aging-in-place to limit the Midwest’s economic growth and to pressure state spending.
- Continued aging-in-place may exacerbate the West’s challenge with housing unaffordability.

Continue reading.

What Does the Puerto Rico HTA Ruling Mean for Special Revenue Bonds? Likely Not as Much as Feared.

Municipalities have long issued “special revenue” bonds, as defined by the federal bankruptcy code, to finance essential service infrastructure projects including water waste and electric utilities. The bankruptcy code provides special revenue bonds with unique features that benefit creditors during an issuer’s bankruptcy. One key provision, Section 922, addresses the timely payment of debt service by an issuer by exempting the payment of special revenues from an automatic stay in bankruptcy.

Last March, the 1st U.S. Circuit Court of Appeals affirmed the decision by the Puerto Rico bankruptcy court, which had stated that Section 922 provides a bankrupt issuer the option, but not the requirement, to pay debt service. On 13 January 2020, the Supreme Court decided it would not hear an appeal in the case, effectively upholding the rulings of the lower courts.

Taken together, the decisions of each of the courts surprised some investors in the $3.8 trillion U.S. municipal bond market. Investors saw them as contrary to the intent of the U.S. Congress when it incorporated the concept of special revenues into the bankruptcy code in 1988. In addition, the rulings differ from established precedent in past municipal bankruptcies. Some investors fear the rulings tarnish the appeal of bonds backed by special revenues and could result in wider credit spreads for issuers.

Fallout is likely limited

Despite these concerns, PIMCO does not expect the HTA ruling to trigger meaningful spread widening in any sector, nor will it likely result in a sustained increase in borrowing costs for higher-quality borrowers. In part, this is because we expect actions by rating agencies will affect only a limited number of credits in cases where large ratings gaps exist between a municipality's special revenue bonds and its general fund obligations.

Bonds backed by special revenue were never completely insulated from the risk of a payment disruption. A distressed municipality may use the threat of a payment disruption on an essential service enterprise to increase its bargaining power over creditors. Arguably, the negotiating leverage of municipalities has increased modestly following the HTA rulings, but the risks have always been present. Consider that when the City of Detroit declared bankruptcy in 2013, the special revenue bonds issued by the Detroit Water and Sewerage Department suffered a significant price decline, but were ultimately paid in full. Thus, issuers of special revenue bonds could face more price volatility if their parent government is of low quality and falls further into distress.

In addition, the lower court's ruling does not strip away all the unique features granted by the bankruptcy code to bonds backed by special revenues. For instance, the security interest granted to special revenues under Section 928 remains intact and enforceable after bankruptcy; that is to say, even after a municipal utility exits bankruptcy, it remains bound by its pledge to use service charges to make interest payments on special revenue bonds. The continuation of the security interest is the most important defining characteristic of special revenue bonds, in our view. It prevents these bonds from becoming unsecured general obligations during bankruptcy.

The HTA ruling may increase the issuance of special tax bonds that have even greater structural protections for investors. An example is debt issued by the Sales Tax Securitization Corporation created by the City of Chicago in 2017. The issuer is a bankruptcy-remote entity and provides a statutory lien over pledged revenues, and the City's transfer of sales tax revenue to the issuer is structured as a true sale. Similar designs could help lower-quality borrowers access cheaper financing for refunding purposes and displace more traditional special tax and general obligation supply.

Ultimately, we believe the lesson of the HTA ruling is a basic one: There is no substitute for fundamental analysis and thoughtful credit selection. The ruling does not diminish our constructive view of special revenue bonds that we believe are supported by stable cash flows and healthy parent obligors, nor does it change our view of the most important legal protections afforded by special revenue bonds, or the way we approach distressed borrowers whose bonds provide investors with appropriate risk-adjusted return.

by Sean McCarthy, Tom Scgyette of PIMCO, 2/28/20

For Small County Governments, Tackling Cybersecurity Basics Can Go a Long Way.

The local governments can face unique challenges when it comes to protecting their computer systems from threats.

To a small county with limited resources, it may sound intimidating to overhaul and adopt new cybersecurity standards.

But if county officials begin by taking small steps to improve their government's overall cyberhygiene – such as using secure passwords and training employees on cyber threats – they may be surprised how quickly they fall in line with industry best practices.

Cybersecurity experts shared tips on how local governments could apply the National Institute of Standards and Technology's cybersecurity framework to their networks on Friday at a panel discussion at the National Association of Counties legislative conference in Washington, D.C.

"Attacks are exploiting vulnerabilities we've known about for a really long time… like the fact we don't do secure passwords very well, we don't do user training," said Patrick Woods, the security assurance lead for state and local government at Amazon World Services.

The NIST framework was designed as a voluntary guide for businesses, organizations and federal, state and local governments to help promote the protection of critical infrastructure and manage cybersecurity-related risks.

Compliance with the framework "comes organically when you start nailing those fundamentals," Woods said.

Ensuring that county information technology officials have a working relationship with those overseeing the budget can be critical to ensuring cybersecurity efforts receive sufficient funding, said Barry Condrey, the chief information officer for Chesterfield County, Virginia.

"If the budget department doesn't understand your cyber posture, you're missing the boat," Condrey said. "Make sure you align with the people who control the money."

Condrey shared his state's experience developing security standards for Virginia's voter registration systems and the difficulties encountered by individual counties.

Virginia lawmakers in 2019 approved legislation directing the state's Board of Elections to draft regulations securing the state's voter registration system and requiring local electoral boards to develop their own security plans.

When stakeholders met to discuss potential development of minimum security standards, Condrey said about one-third of the governments represented didn't have a person on staff who was responsible for information technology security across the government. Officials were also worried about the time and resources that would be needed to develop and meet the new requirements.

Once the state adopted the standards, Condrey said officials were not able to act immediately because they missed the budget cycle for the year. He recommended that any efforts to implement new security standards be closely tied to budget discussions so that there is money to pay for initiatives.

"Anytime a state tries to impose its will on local government, particularly with an unfunded mandate, it generally does not go well," he said.

Route Fifty

by Andrea Noble

FEBRUARY 28, 2020

Why Public Pension Debt And Social Insurance Finances Are Not The Same.

Continuing my series of, well, sharing old, bookmarked items, here's a scholarly article from July 2019: "The Sustainability of State and Local Government Pensions: A Public Finance Approach," by Jamie Lenney of the Bank of England, Byron Lutz of the Federal Reserve Board of Governors, and Louise Sheiner of the Brookings Institution.

Here's some background:

A week ago, I wrote about the French concept of "intergenerational solidarity" and their use of the term not to express all generations forging a consensus on how to best meet the needs of the elderly as well as, well, everyone else who has needs, but instead to explain their practice of intentionally not funding their version of Social Security retirement benefits, and promising that each generation funds benefits for their elders and is in turn promised the same benefits then they reach old age.

Continue reading.

Forbes

by Elizabeth Bauer

Feb 28, 2020, 04:22pm

Infrastructure Roundtable on Capitol Hill.

BDA Partnering with the Public Finance Network, GFOA, the National Association of Counties, the American Public Power Association and BDA member firm Hilltop Securities

Next week, the Municipal Bonds 101: Modernizing Infrastructure into the 21st Century.

The flyer circulated on Capitol Hill can be viewed here.

The panel will be moderated by Anne Burger Entrekin, Hilltop Securities Regional Managing Director and will feature:

- Kendel Taylor, Finance Director, City of Alexandria, VA (GFOA)
- Commissioner Kevin Boyce, Franklin County (OH) (NACo)>
- Jolene Thompson, Executive Vice President of Member Services and External Affairs, American Municipal Power (APPA)

The discussion will serve as an educational event for Capitol Hill staff, while promoting BDA< andPFN priorities such as:

- Continued support and protection of the tax-exemption;
- The reinstatement of tax-exempt advance refundings
- Raising the limit on BQ debt;
- The expansion of PABs;
- Working to ensure that BABs, if reinstated, would be uncoupled from sequestration.

The BDA will provide an update next week following the event.

Bond Dealers of America

February 26, 2020

[Muni Bonds Stage Biggest One-Day Rally Since 2017.]

- **Top-rated, 30-year bond yields tumble 10 basis points to 1.59%**
- **'I'm shocked it's gone as low as it has,' investor says**

Just when municipal bonds didn't seem to have much more room to rally, the fear cast by the coronavirus is driving them to their biggest one-day jump in more than two years.

As stocks plunged worldwide and investors rushed into the safest assets, the yields on top-rated state and local government debt maturing in 30 years plunged 10 basis points to 1.59%, the biggest one day drop since December 2017, according to the Bloomberg BVAL index. Those on 10-year benchmark tax-exempt bonds fell 7 basis points to 1.03%.

The economic uncertainty posed by the spreading coronavirus is spurring a market that had already been rallying since late 2018, driving yields to the lowest since the 1950s, as investors poured money into state and local government bond mutual funds. Such funds picked up about $1.8 billion of new cash during the week ended Feb. 19, according to Refinitiv Lipper US Fund Flows data.

"Investors are fleeing to high-quality assets as the market freaks out about the coronavirus spreading to other places besides China," said Jason Appleson, a portfolio manager at PT Asset Management.

"I'm shocked it's gone as low as it has so nothing would surprise me at this point if we continue to see contagion," he said. "It seems the market is very focused on what the economic implication of coronavirus is."

The rally has pushed yields so low that investors have been shifting into the longest-dated debt to pick up slightly better yields, said Peter Block, head of municipal strategy at Samuel A. Ramirez & Co.

"If there is any value to be had in the market, it's going to be the 30-year right now," Block said, though that value will be taken out pretty quickly as continued buying pushes the yield down even further. He said it's like a "mini sale with limited supply."

Bloomberg Markets

By Mallika Mitra

February 24, 2020, 10:29 AM PST

— With assistance by Danielle Moran, and Amanda Albright

Rush to Invest in Municipal Debt Pushes Yields to Record Lows.

Municipal-bond yields are hitting 38-year lows due to investors' coronavirus concerns driving up demand in the $4 trillion muni market.

Fears of the coronavirus's impact on global markets led to a stock selloff on Monday and Tuesday. Investors flocked to munis and other fixed-income investments for stability. The S&P Municipal Bond Index continued to climb Tuesday after logging its biggest one-day gain in 20 months Monday. A daily gain that big—about one-third of a percentage point—has occurred only five times in the past three years.

"Fear is present and investors are taking some risk off the table," said Sylvia Yeh, co-head of municipal fixed income at Goldman Sachs Asset Management. "That de-risking could mean [they buy into] cash, Treasurys or munis."

The new wave of demand Monday pushed bond yields to once-unheard-of levels. Yields on high-grade tax-exempt 30-year municipal bonds fell to 1.594% Tuesday, 47% lower than in February of last year, according to financial analytics company ICE Data Services' Muni Yield Curve. Bond yields fall as prices rise.

Daniel Berger, senior market strategist at Refinitiv, said "there's no end in sight" to low muni yields. The firm, which tracks state government-bond yields going back to June 1981, showed its lowest yields on record Wednesday for the second day in a row.

Lower yields mean less income for investors and some of them are seeking out less creditworthy borrowers in an effort to find higher returns. At the same time, the falling yields reduce borrowing costs for municipal-bond issuers and make borrowing easier for less creditworthy governments and nonprofits.

Muni-bond prices were climbing steadily even before coronavirus headlines spooked investors. Changes in the 2017 tax law drove up demand in high-tax states by capping the federal deduction for state and local taxes, making tax-exempt munis more attractive. At the same time, the tax law reduced supply by placing new limits on when governments can issue tax-exempt debt.

Quick moves into or out of municipal-bond investments have become easier to execute in the past decade with the proliferation of muni mutual funds and exchange-traded funds, which now hold $852 billion worth of munis, according to the Federal Reserve. Municipal-bond funds reported net inflows of $96.5 billion last year, a 28-year record, according to Refinitiv, and $1.8 billion in inflows for the week ended Feb. 19, the most recent data available.

Fund managers working overtime to field calls from concerned investors expect that number to go up this week.

"There's positive correlation with volatility and how many hours we work here," said Justin Pfaff, municipals product manager at investment management company Nuveen.

The Wall Street Journal

By Heather Gillers

Updated Feb. 26, 2020 4:16 pm ET

Current Important Things About High-Yield Munis.

Municipal bonds are often considered lower risk fixed income alternatives and as such carry lower yields than, say, corporate debt. However, there are avenues for investors looking for more municipal income, including the VanEck Vectors Short High-Yield Municipal Index ETF (SHYD C+) and the VanEck Vectors High-Yield Municipal ETF (HYD A-).

Municipal bonds, also known simply as munis, are debt obligations issued by government entities. Like other forms of debt, when you purchase a municipal bond, you are loaning money to the issuer in exchange for a set number of interest payments over a predetermined period of time. At the end of that period, the bond reaches its maturity date, and the full amount of your original investment is returned to the investor.

An important part of the near-term thesis for ETFs such as HYD and SHYD is that default rates remain low.

“The total par value of first-time non-payments of interest or principal due was $3.6 billion in 2019,” said VanEck in a recent note. “This is just 0.09% of the $3.82 trillion market. Recent defaults have been generally from smaller healthcare sub-sectors such as nursing homes and continuing care retirement communities (CCRCs). These alone represented nearly three-quarters of last year’s total.”

Evaluating The Options

Since muni bond interest is exempt from federal taxes, muni ETFs are a good way for investors seeking tax-exempt income, especially those in higher tax brackets. Due to its tax-exempt status, the asset category is also best utilized in taxable accounts.

Another important element to consider with HYD and SHYD this year is that regardless of the presidential election, demand for muni debt remains strong.

“The leading Democratic candidates support higher and/or new income taxes on high-income earners,” according to VanEck. “Higher taxes historically support demand for tax-exempts, and even the possibility of higher taxes could contribute to positive fund flows. If Trump wins reelection, federal tax policies are likely to remain unchanged. No matter the outcome, we expect continued demand for municipal bonds.”

Favorable fundamentals will continue to support the municipal bond market, especially for high-yield munis and related ETFs. Supporting the munis market, the robust demand and relatively low supply has helped bolster prices.

“The total issuance of municipal bonds expanded by 21.9% in 2019,” according to VanEck. However, this was not nearly enough to meet the reinvestment demand generated by calls, coupon payments, and maturing bonds, let alone the demand from mutual fund and ETF fund inflows, which totaled $93.6 billion last year.”

ETF Database

February 26, 2020

[Investors Run to Municipal Bond ETFs for Safekeeping.]

Fixed-income investors are placing more attention on municipal bond ETFs, with muni bonds rallying and yields closing in on four-decade lows, as coronavirus concerns push more into the munis market.

For instance, the Vanguard Tax-Exempt Bond ETF (VTEB A-) has attracted $750 million in net inflows and iShares National Muni Bond ETF (MUB A+) brought in $780 million in inflows year-t--date, according to ETFdb data. VTEB tracks the Standard & Poor's National AMT-Free Municipal Bond Index, which measures the performance of the investment-grade segment of the U.S. municipal bond market. MUB seeks to track the investment results of the S&P National AMT-Free Municipal Bond Index, which also measures the performance of the investment-grade segment of the U.S. municipal bond market.

As fears of a spreading coronavirus intensified this week, investors shifted over to munis and other safe-haven fixed-income assets. Consequently, the S&P Municipal Bond Index experienced its biggest one-day gain in 20 months on Monday, the Wall Street Journal reports. A daily gain of about one-third of a percentage point has only occurred five times over the last three years.

"Fear is present and investors are taking some risk off the table," Sylvia Yeh, co-head of municipal fixed income at Goldman Sachs Asset Management, told the WSJ. "That de-risking could mean [they buy into]cash, Treasurys or munis."

The sudden spike in demand for safe-haven bets dragged bond yields to unprecedented low levels. For instance, yields on high-quality, tax-exempt 30-year municipal bonds dipped to 1.627% Monday, or 46% lower than in February of last year, according to financial analytics company ICE Data Services' Muni Yield Curve. Bond yields have an inverse relationship to prices.

Daniel Berger, senior market strategist at Refinitiv, believed that "there's no end in sight" to low muni yields.

The lower yields have even caused some to take on riskier bets in search of more attractive payouts. For example, the VanEck Vectors High-Yield Municipal ETF (HYD A-) attracted $407 million in net inflows so far this year.

Yields on munis have been steadily falling with bond prices rising even before the coronavirus hubbub. After the 2017 tax law changes, demand for tax exempt munis became more attractive in response to caps in the federal deduction for state and local taxes, especially among more high-tax states. The tax law also diminished supply due to new limits on when governments can issue tax-exempt debt.

ETF Database

February 27, 2020

[Climate Change Is Coming to Your Hometown Bonds.]

Startup risQ wants to be the go-to tool to assess natural-disaster risk in the municipal

market.

In some corners of finance, climate-change risks are only starting to appear on investors' radars. By contrast, in the $3.8 trillion U.S. municipal-bond market, natural disasters have been a nagging concern for decades.

In the wake of Hurricane Katrina in 2005, Moody's Investors Service slashed New Orleans's credit rating by three levels to junk. It didn't win back its investment grade until May 2007. Joplin, Missouri, suffered the deadliest U.S. tornado in almost six decades in May 2011. Two years later, almost half of its 7,500 students were still in temporary classrooms, but construction progressed on new schools thanks in part to voters approving the largest bond sale in city history. In August 2014, the strongest earthquake in 25 years hit Napa County, California, and traders exchanged a record amount of its debt in the following days amid concern that it could halt payments because of the damage. The list goes on.

Yet for all the examples, pinning down the risk has always been elusive for the muni market, which is known for its dispersion. The U.S. has more than 90,000 "local government units," according to the most recent Census data, and although not all of them issue bonds, those that do tend to borrow across a range of maturities and with varying revenue streams. While many deal documents now include some language about climate change, and investment banks and legal counsels are more thoroughly conducting due diligence around the issue, ultimately there's little evidence that the risks are baked into bond prices.

Continue reading.

Bloomberg Markets

By Brian Chappatta

February 21, 2020, 3:00 AM PST

Fitch Rtgs: States Increasingly Budget for Climate, Environment Initiatives

Fitch Ratings-New York-20 February 2020: Long-term costs to states of environmental mitigation, recovery projects and climate initiatives are expected to rise, says Fitch Ratings, particularly as an increasing number of states include environmental considerations in enacted or recent executive budget proposals. These programs are also expected to become a more prominent part of future state budgets amid greater attention to environmental, social and governance (ESG) concerns.

Boosting environmental resilience is a long-term commitment that many states are expected to address in incremental steps, with immediate attention given to life-saving measures, such as fire and flood prevention, followed by more aggressive moves to reach zero-carbon emissions or tackle sea level rise. States believe that investing in capacity building programs will help reduce the costs of future climate or weather related events, but Fitch expects identifying recurring funding sources will be challenging, particularly as spending pressures continue, especially Medicaid and pensions.

New York's governor proposed the largest amount by far in his fiscal 2021 $178 billion budget: a $33 billion five-year plan to tackle climate and environmental concerns and build resiliency. The proposal includes a $3 billion environmental bond program that would invest in coastline resiliency projects, supplemented with an additional $740 million in state funding, $28 billion for green energy projects and $1.5 billion for carbon-free transportation. This proposal follows the 2019 Climate Leadership and Community Protection Act, which targets reductions in state-wide greenhouse gas emissions and renewable energy gains.

California's governor proposed $12.5 billion in spending over five years in his fiscal 2021 $222 billion budget for a climate resilience plan that includes $4.8 billion in bonds for investments in resiliency and protection, most of which will address immediate vulnerabilities to floods and fires, improve groundwater and farm water systems, and protect drinking water and fish habitats. The proposal furthers investment in fire protection by dedicating $100 million to make homes resistant to fires and creating a four-year, $1 billion revolving loan program to promote recycling, low-carbon transportation, and environmentally conscious agriculture programs. In addition to the bond program, $965 million in funding would come from the state's existing cap-and-trade program.

Fitch notes some states that have not traditionally provisioned for environmental concerns in their budgets have recently enacted measures to apply funds for these purposes. Texas made flood resiliency and hazard mitigation a key priority in its 2019 legislative session, appropriating about $2 billion from the state's then $12.6 billion rainy day fund for flood mitigation and resiliency projects, and to provide funds to cover damages from Hurricane Harvey. The Texas Water Development Board's responsibilities for flood planning and financing were expanded, and the legislature made a one-time transfer of $793 million from the state's economic stabilization fund to create a new flood financial assistance program.

Similarly, in 2019, Florida ramped up its investment in environmental protection, with the governor dedicating $2.5 billion in spending over four years for Everglades restoration, protection of water resources, and establishing a state resiliency office. Massachusetts enacted legislation in 2018 authorizing more than $2.4 billion for a municipal vulnerability preparedness grant program and a state-wide hazard mitigation and adaptation plan. Oregon's governor recently proposed a bill to spend $200 million per year over the next 20 years on wildfire prevention and mitigation.

Many other states have not taken action in their budgets on environmental protection and conservation initiatives, and this may result in greater costs in the long run. States that have not invested in mitigation and prevention efforts up front may face rising costs to address weather-related disasters in the future.

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Credit Card Surcharges for Municipalities.

In the course of providing services and resources to its community, a municipal government might consider accepting credit card payments from its citizens. Just like any business, a city, county, township, or village must enter into a merchant agreement with each credit card brand it intends to accept before it can begin dealing in plastic.

It is easy to assume that all of the major credit card companies offer generally the same things, but each contract is likely to have nuanced differences that may be important to you as the municipal merchant. We recommend that you reach out to an experienced municipal or financial services attorney before entering any credit card agreement.

However, understanding a few general guidelines may help your community know what to expect. To accept credit cards, most merchants will need to enter into an agreement with both a credit card company and a bank known as an “acquirer” which administers the transactions in exchange for a fee. Not every merchant will use the same acquirer which means that not every merchant agreement will be consistent in its administration costs. A significant aspect of most merchant agreements is the way surcharges are assessed and passed on to the consumer.

There are three things to know:

1. It is important to understand that surcharges apply only to credit card transactions and cannot be assessed for debit card or prepaid money card purchases.
2. Most credit card companies differentiate between a “brand-level surcharge,” where all credit cards from a particular company (e.g. Visa, Mastercard, etc.) are charged at the same rate and a “product-level surcharge,” where the charge is determined by the particular credit product offered by a brand. Merchants may typically impose a surcharge in either way, but must make a choice.
3. Merchant agreements will have a “maximum surcharge cap,” meaning a maximum amount that a merchant can pass along to a customer for a transaction. In most instances, the cap is around 4%, but charges may not exceed the actual merchant costs, which are the fees payable from the merchant to the credit card company and acquirer bank. This could effectively provide a cap below 4%.

Some cards may even have built-in restrictions for handling surcharges with competitive brands, demanding consistency across all cards you accept. That may be an important aspect of deciding which credit cards you want to accept and which you’d prefer to decline. Additionally, each card has specific rules for how information about the cards you accept must be displayed. Often these rules relate to the font, language, and location of specific disclosures that must appear at both at the point-of-entry for your merchant and at the point-of-transaction.

Credit card processing services like Square or Clover may simplify and streamline your processes and remove some of the work from accepting credit. However, municipalities should always consult with counsel before entering any agreement with lasting implications.

Foster Swift Collins & Smith PC – Alexander J. Thibodeau

February 18 202

S&P: U.S. Ports Face Headwinds

Table of Contents

Key Takeaways

- **We modified our port sector outlook on Jan. 15, 2020, to negative from stable.**
- **We believe the sector remains strong, though the still-unsettled U.S.-China trade policies, ongoing tariff disputes, and the developing economic and supply chain fallout due to COVID-19 could weigh on these issuers.**
- **We expect issuers in the port sector will increasingly integrate emerging risks, including cyber- and climate-related risks, into their long-term business strategies and capital planning.**

The U.S. port sector is inherently exposed to volatility due to the normal business cycle, shifting trade patterns and supply chains, drastic fluctuations in commodity prices, and changes in both bilateral and multilateral trade policies. Now added to the list is fallout from the new coronavirus (COVID-19) outbreak, which S&P Global Ratings believes will undermine the credit strength of many Chinese infrastructure operators in 2020 and negatively affect exports (see “Coronavirus Will Take A Big Toll On China’s Transport Operators” published Feb. 3, 2020, on RatingsDirect). Many of our U.S. rated ports have very strong business profiles and strong financial metrics, particularly debt service coverage and low debt levels, relative to other transportation sectors. Historically, these metrics have provided cushions for these issuers to absorb volatility and maintain their current rating profile. In our view, the likely implementation of the new U.S.-Mexico-Canada Agreement (USMCA) and the U.S.-China “Phase One” trade agreement lessens the near-term risks somewhat. However, we feel there is still a high level of uncertainty regarding Asia trade and longer-term shifts in trading patterns and supply chains that will produce winners and losers and dampen volumes and revenues at some ports.

Continue reading.

S&P U.S. Independent Schools Fiscal 2019 Medians And 2020 Sector Outlook: Steady As She Goes, For Now

Table of Contents

Outlook: Stable
While the sector faces broad risks, we expect ratings stability through 2020. The stable outlook reflects healthy financial and enterprise profiles for our rated schools–with steady enrollment and demand, proactive management oversight, good revenue diversity, and growing resources, building upon solid fundraising efforts and steady market returns.

Continue reading.

Muni-Bond Market's Favorite No-Risk, Can't-Lose Trade Is Back.

- **Floating-rate yields jump above those on 10-year debt**
- **'It's the best buying opportunity of the year,' investor says**

The municipal-bond market's favorite can't-lose trade is back.

So called variable-rate demand obligations — which are virtually risk proof because they can be sold back at full face value to Wall Street banks as frequently as every day — are yielding 1.18%, more than fixed-rate municipal bonds that don't mature for a decade. And those yields have been steadily rising since mid-January, in contrast to the rest of the $3.8 trillion municipal market.

The disconnect is the result of a frequently seen seasonal quirk: Because variable-rate debt can be sold so easily, and at 100 cents on the dollar, investors often unload it to raise cash to cover their annual tax bills. As a result, banks' inventories of the securities tend to build up, prompting them to reset interest rates higher to draw new buyers. The Securities Industry and Financial Markets Association's index, the floating-rate benchmark, surged more than 80 basis points last April to as much as 2.3%, the highest since the 2008 credit-market collapse.

This year, even payouts not far above 1% may still be enticing at a time when yields are hovering near the lowest since the 1950s. Barclays Plc strategists led by Mikhail Foux last week flagged them to clients.

The yields have room to move even higher as the tax filing deadline on April 15 approaches, because high-net worth investors tend to wait until the last few weeks to liquidate their portfolios, said Kristian Lind, a managing director at Neuberger Berman Group. He said investors should hold the securities until yields hit a peak around March and April and then re-deploy their cash elsewhere.

"The market is basically on sale for all of March and April," Lind said. "It's the best buying opportunity of the year for the front-end of the yield curve."

Bloomberg Markets

By Mallika Mitra and Amanda Albright

February 20, 2020, 10:34 AM PST

New Muni World Sees Rise In Taxable Bonds: Kazatsky (Radio)

MUNIS in FOCUS: Eric Kazatsky, Senior U.S. Municipals Strategist for Bloomberg Intelligence, discusses bond yields and the shifting market for munis. Hosted by Lisa Abramowicz and Paul Sweeney.

Play Episode

Bloomberg

February 21, 2020 — 8:48 AM PST

Municipal Bond Market Outlook: 2020

Due to the dynamic nature of financial markets, they are susceptible to an array of factors from around the world, and municipal debt markets aren't immune to these events. While 2019 witnessed strong U.S. economic growth due to strong consumer spending and historic low unemployment rates, the year 2020 started with tumultuousness in U.S.-Iran relations, presidential impeachment, and global unrest due to Coronavirus.

So far, these events have yet to show an impact on U.S. financial markets and the Federal Reserve is projected to have a stable outlook on interest rates. In addition, contrary to popular opinion, the Fed decided to cut rates in 2019, which was paired with the global demand for yield and credit spread exposure, enabling more local governments to save on net interest costs by issuing taxable bonds to pre-refund outstanding tax-exempt debt.

In 2019, municipal debt funds witnessed continued inflow of funds from investors and the issuance of new municipal debt registered $421 billion due to the lower interest rate environment.

In this article, we will discuss the 2020 outlook for municipal debt markets from both the issuance and investor standpoints.

Continue reading.

municipalbonds.com

Jayden Sangha

Feb 19, 2020

Fitch Rtgs: Bondfield Default Highlights Project Completion Contractor Risk

Fitch Ratings-New York-11 February 2020: The default of a private project contractor for a number of large Design-Build Finance (DBF) social public-private partnership (P3s) projects in Canada highlights the need for robust risk assessment and efficient risk allocation, Fitch Ratings says. Bondfield Construction Company Limited defaulted on its payment obligations for a number of projects for which it served as contractor and filed for insolvency protection. The issues with Bondfield are the latest among a number of high profile construction challenges in the P3 sector, including the I-69 and Denver Great Hall projects, which underscore the importance of understanding and appropriately mitigating key completion risks.

Fitch recently published an Exposure Draft: Completion Risk Rating Criteria, which focuses attention on contractor risk and allocating risk across multiple parties.

Work on the Bondfield projects, located in the province of Ontario, has been delayed from a few months to more than a year as the government sponsor, Infrastructure Ontario, the surety provider, Zurich Insurance Company Ltd, and bank lenders have been working to find a solution to the defaults. The projects employed standard DBF structures, with banks providing all of the financing through construction loans. There was no equity injection, nor was there a project company that actively managed the construction process.

Although relatively simple in scope, the DBF structure used in these projects provided very little liquid security. The lack of adequate liquidity to cover the short and medium-term incremental costs of contractor replacement, such as search and retendering costs, meant lenders were reliant on the sureties when the contractor defaulted. Although sureties typically guarantee completion, they do not guarantee timely completion because the adjudication of claims can take a long time. The Bondfield projects ran out of liquidity before the surety provider was asked to step in. Public information is limited as these projects are not rated.

Many years of successful delivery of social P3s in Canada led to a level of comfort with contractor/completion risk and an increase in competitiveness in the sector that resulted in a compression of construction margins. Underestimating completion risk can result in bids that are mispriced for the level of risk present and lead to cost overruns and delays. In a competitive environment, contractor replacement may also become a challenge because potential replacement contractors are unlikely to assume the contract if the risk is significantly mispriced and will require a significantly higher cost/premium to complete.

Fitch's completion analysis is heavily dependent on the opinions of technical experts, independent engineers (IEs). However, the processes and standards used in developing these opinions vary, and the influence of the issuer cannot be ignored. Fitch's Exposure Draft: Completion Risk Rating Criteria consequently identifies minimum levels of performance security required to cover replacement costs relative to the IEs' estimates based on contractor ratings.

These levels represent Fitch's experience and judgment, which is informed by discussions with a variety of market experts with considerable experience in construction projects that have experienced delays and cost increases following a contractor default. Fitch will review the IE's opinion and engage in discussions to ensure there is a complete understanding of the processes and standards used. The 'right-sizing' of performance security, both short-term liquid security and long-term performance security, to cover costs of replacing the contractor is vital to mitigate completion risk.

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Fitch Ratings: Coal Industry Declines Fueling Weaker Demographics for Some U.S. States

Fitch Ratings-New York-11 February 2020: The days of coal production meaningfully contributing to state economies appear to be numbered, posing a drag on state GDP, employment, and revenues and contributing to weaker demographics for some coal-producing U.S. states, according to a new report from Fitch Ratings.

Coal production has declined steadily for over a decade, though direct mining's contribution to U.S. states' economies has remained fairly steady. Notable outliers include West Virginia, where mining's contribution to state GDP gradually descended from 11.4% in 2008 to 7.2% in 2017. Wyoming is another notable outlier with mining's importance slightly growing over this time frame from 12.2% of state GDP in 2008 to 13.4% in 2017. However, this reflects Wyoming's 0.8% annual loss in total GDP over this time reflecting contractions in multiple industries.

Mining activity contributions to state GDP are likely to have softened in 2019 (based on data through the third-quarter). And as the coal industry continues to retract and the secondary impacts of employment and economic loss are incorporated, states unable to replace this economic engine have and will continue to suffer weakening demographics according to Senior Director Marcy Block. 'Met coal prices will exhibit short-term volatility due to numerous factors, and the current coronavirus outbreak also poses downside risks to global demand.'

'Some coal producing states are seeing declines in population and a greater proportion of aged residents, although these trends can be felt more acutely at lower levels of government,' said Block. 'Most coal-producing states have also seen significant losses in coal mining-related employment since 2011, particularly in those states where the industry was heavily labor intensive.'

In total, 41,773 coal mining jobs were lost between 2011 and 2018 with the largest job losses occurring in Kentucky (12,939 jobs) and West Virginia (10,807). For those states with the largest coal mining presence, retraction in this industry has been a drag on overall growth in nonfarm employment. Conversely, coal-related employment has grown in Montana and North Dakota since 2011.

Of the top 10 coal producing states, West Virginia's demographic trends are among the least favorable. Weak trends in population levels, aging of residents and unemployment are also common among Kentucky, Montana and Wyoming, whereas strong growth in oil and gas development (Colorado, North Dakota, and Texas) in addition to other sectors (Colorado and Texas) have strengthened trends in these states' population, GDP and employment.

'Global Trends Sustain Uncertainty for U.S. Coal Producing States' is available at 'www.fitchratings.com'.

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[S&P: U.S. Airport Sector Well-Positioned While U.S. Ports Prepare For Volume Declines Under Our Baseline Coronavirus Scenario.]

NEW YORK (S&P Global Ratings) Feb. 12, 2020–Based on our initial sample survey of U.S. airport operators, most are well-positioned to manage the operational and financial implications associated with our baseline economic assumptions related to the 2019 new coronavirus (COVID-19) outbreak. However, U.S. ports with exposure to China are preparing for a likely decline in container volume and further softening in trade, as cancelled shipping calls and trade in goods in both directions will be substantially affected by supply outages and disruptions to logistics networks. (For the most current overview, see "Global Credit Conditions: Coronavirus Casts Shadow Over Credit Outlook" published Feb. 11, 2020.)

S&P Global Ratings' baseline assumption is that COVID-19 will be contained globally in March 2020, allowing travel and other restrictions to be unwound by the middle of the second quarter. We estimate that the virus could lower China's GDP growth by 70 basis points (bps), to 5.0%, this year, with a peak effect in the first quarter before a rebound begins in the third quarter, and lost output largely recovers by the end of 2021. In turn, it would trim 30 bps from global GDP growth this year. However, if the outbreak is not brought under control in March, the economic impact could be much larger.

To assess what effect, if any, COVID-19 will have on U.S. airport sector, S&P Global Ratings surveyed a select group of airports mostly where U.S. health officials are conducting enhanced screening of passengers. Airports included in our sample are:

- Chicago's O'Hare International Airport
- Dallas-Fort Worth International Airport
- Guam International Airport

- Honolulu International Airport
- John F. Kennedy International
- Los Angeles International Airport
- Newark Liberty International Airport
- San Francisco International Airport
- Washington Dulles International Airport

Our findings are as follows:

- Most of the airports we surveyed have limited exposure to flights from China;
- None of the airports have revised current enplanement forecasts for 2020 as yet, although we anticipate those with greater exposure will see some softening; and
- The cost recovery financial structure of airports mitigates the financial impact of lower-tha--expected activity levels.

We anticipate the generally favorable overall enplanement forecasts for this year will mitigate any potential weakening in air travel demand related to this health emergency under our baseline scenario.

For the U.S. port sector, we see the COVID-19 outbreak as an additional risk–on top of weakness due to the ongoing trade and tariff dispute–if it becomes a drag on the overall Chinese economy, dampening GDP growth that, in turn, will cause lower-than-forecast levels of goods imported to or exported from China. The demand shock is larger for China than for its trading partners, so all else being equal, this should mean that the decline in imports of goods and services (including tourism) will be larger than that for global exports. At the same time, trade in goods in both directions will be substantially affected by supply outages and disruptions to logistics networks. Overall, it seems likely that imports will be hardest hit and this will provide an offsetting, but moderate, positive contribution to growth that will unwind later in 2020. (Continue to check our website for an update on the port sector at https://www.spglobal.com/ratings/en/sector/u-s-public-finance/transportation)

We consider this latest health emergency an evolving one that we believe is still in its early stages. Therefore, it is difficult to say if it will have a material impact on those U.S. airport and port credits we rate. Consequently, this potential risk does not change the positive and negative 2020 sector outlooks we have for the airport and port sectors, respectively. During past outbreaks, we took no negative rating actions, since their impact was temporary. For example, the SARS coronavirus outbreak in 2003 led to a 14% reduction in total passengers for San Francisco International Airport's Asia traffic for the year, followed by a 19.5% rebound in Asia traffic the following year. However, should this outbreak create a persistent, durable, and material drag on air travel demand or trade flows, we would consider it a major credit risk, potentially leading us to lower the ratings on some issuers.

Related Research

Global Credit Conditions: Coronavirus Casts Shadow Over Credit Outlook, Feb. 11, 2020
Unless Coronavirus Spreads More Widely, Its Impact On The U.S. Economy Should Be Modest, Feb. 11, 2020
Coronavirus To Inflict A Large, Temporary Blow To China's Economy, Feb. 7, 2020
Coronavirus Impact: Key Takeaways From Our Articles, Feb. 12, 2020
Australian And New Zealand Airports Brace For More Pain With Coronavirus Outbreak, Feb. 4, 2020
Coronavirus Will Take A Big Toll On China's Transport Operators, Feb. 3, 2020

S&P U.S. State Ratings And Outlooks: Current List

View the list.

CUSIP: Municipal Volumes Increase Year over Year.

“So far this year, we’re starting to see pockets of very strong CUSIP request volume emerge in specific asset classes, most notably in corporate debt,” said Gerard Faulkner, Director of Operations for CUSIP Global Services. “There is some volatility in the data, however, with other asset classes such as international debt and equity and some municipal categories still making big month-t--month moves.”

Read Press Release.

Bill Offers $400M for State, Local Government Cybersecurity.

The just-introduced bipartisan bill would send the money to state and local governments through the Department of Homeland Security, which would also create a new federal strategy for cybersecurity.

With state and local governments beset by a precipitous rise in cyberattacks, new federal legislation might provide some necessary cover where needed.

The State and Local Cybersecurity Improvement Act would create a grant program worth $400 million to finance cybersecurity efforts in communities across the country, according to a release. Eligible communities would be able to apply for funds, provided through the Department of Homeland Security, which would be allocated to assist in areas like vulnerability scanning and testing, cyberworkforce development and intelligence sharing, according to the bill text.

The bill would also require DHS’ Cybersecurity and Infrastructure Security Agency (CISA) to develop an overall strategy to improve the cybersecurity posture of those communities. Communities would also be obligated to create their own cybersecurity plans, illustrating how monies would be spent in service of those goals.

The legislation, which was introduced by a group of bipartisan representatives associated with the House Committee on Homeland Security, offers a potential workaround for cash-strapped municipalities looking to bolster their security budgets.

One of the sponsors of the bill, Cedric Richmond, a Louisiana representative and chair of the Homeland Security Committee’s Cybersecurity, Infrastructure Protection and Innovation Subcommittee, explained in a statement his support for the legislation.

“Louisiana has long been vulnerable to cyberattacks, and this bill offers the resources needed to ensure protection against potential threats,” said Richmond. “I’m proud to introduce this comprehensive measure to give Louisiana and other states across the country the proper framework they need to implement vital cybersecurity plans.”

GOVTECH.COM

BY LUCAS ROPEK / FEBRUARY 12, 2020

BDA Submits Testimony and Will Host Capitol Hill Briefing in Support of Infrastructure Proposal.

Today, February 12, 2020, after consultation with the Municipal Bond Executive Committee, the BDA submitted testimony to the House Committee on Ways in Means in response to a recent hearing titled, *Paving the Way for Funding and Financing Infrastructure Investment* and in support of the House infrastructure principles document.

The BDA Comments can be found here.

The BDA also co-signed a letter from the Public Finance Network, along with 25 organizations, in support of the tax-exemption and other market priorities.

The letter can be viewed here.

Both the BDA comments and the PFN letter wrote in support of:

- Continued protection of the tax exemption;
- Reinstatement of tax exempt advance refundings;
- Expanding the cap and scope of qualified private activity bonds;
- Raising the limit on bank qualified debt; and
- Ensuring any federal direct pay bond legislation would be untethered from sequestration

Muni 101 and Infrastructure Hill Briefing

The BDA, along with member firm Hilltop Securities, has partnered with the Government Finance Officers Association, the American Public Power Association and the National Association of Counties for a March 3rd Capitol Hill briefing for Members of Congress and their staff.

The briefing will provide a “Muni Bonds 101” tutorial followed by a discussion on infrastructure and the need for municipal bonds to be a part of the solution.

The BDA will provide a recap following the event.

Bond Dealers of America

February 12, 2020

Fitch Rtgs: Growing US Infrastructure Deficit Necessitates a New Paradigm

Fitch Ratings-New York-14 February 2020: Any government plan for renewing and advancing essential US infrastructure requires a new paradigm to adequately address the infrastructure funding deficit, says Fitch Ratings. While a source of adequate and sustainable funding is a critical component, a results-oriented, objective and strategic approach to investment, along with responsible stewardship of the public purse, are paramount. Increased spending without a strategic, comprehensive approach to infrastructure investment based on national priorities will not go far in addressing the continued deterioration of critical economic assets.

Passage of a large-scale federal infrastructure spending bill stalled in 2019 due to a lack of consensus on a funding approach, despite bipartisan recognition of the need to address the country's aging infrastructure. Political disagreements partially reflect difficult budget decisions, which will need to be made in the context of a federal deficit that is projected to reach $1.0 trillion this fiscal year. Trying to tackle the issue in a presidential election year will be next to impossible.

Addressing US infrastructure needs will require a significant uptick in annual new investment. Prior government proposals have been rather tepid, suggesting up to $200 billion in new investment a year. While a good start, it is a drop in the bucket, as a multi-trillion dollar infrastructure deficit will require a glide-path to trillion dollar annual investments at 5% of US GDP and more than double recent historical levels to have a meaningful impact. Direct federal spending on nondefense infrastructure, as a percentage of GDP, declined marginally over the past two years and was less than 0.1% of GDP in 2018.

Investments in infrastructure have historically led to increased economic activity and growth. The risk of putting off investment is obvious: infrastructure assets, which are essential to the US economy, will continue to deteriorate, requiring even greater financial resources down the line and making the problem even more difficult to address. Slowing GDP growth will compound this risk, making increased investment less feasible. The irony is that the ability to invest is strongest when the economy is robust.

Such a large-scale undertaking requires a coordinated effort across multiple stakeholders and levels of government to prioritize and fund national needs and provide long-term support for infrastructure renewal. An independent, non-partisan infrastructure commission with the teeth to influence funding and spending may be a useful model to facilitate sustained planning and investment.

With no federal plan currently in place, states and local governments have made efforts to fill the funding gap, including raising gas taxes, using toll revenues for other unrelated projects, or entering into public-private partnerships. State and local spending on infrastructure was about 1.5% of GDP in 2018 but infrastructure needs are too great to address on their own. States and municipalities need funding visibility and assistance to begin work on necessary projects.

Costs associated with repairing and protecting infrastructure will only grow if the funding gap is not addressed systematically. The deficit could be exacerbated with the potential threats to infrastructure from environmental risks such as rising sea levels. Upfront investments to build resiliency would cost less than rebuilding following weather-related events.

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Additional information is available on www.fitchratings.com. The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

Dude, Where's My Infrastructure Funding?

Ever since both 2016 presidential candidates made infrastructure investment a core component of each of their platforms, we have been waiting for a significant infusion of federal funds to modernize our aging bridges, highways, and transit systems. One of the few remaining bipartisan issues, members of both political parties had high hopes that a large infrastructure bill would be possible. While this has yet to materialize, the Senate, House, and Administration have all taken steps to advance the ball. But with the current transportation law—the Fixing America's Surface …

Continue reading.

Nossaman LLP

By Shant Boyajian on 02.14.2020

Everything Is Great in Muni-Bond Market. That's the Big Worry.

- **If everyone is on same side, it topples over 'pretty easily'**
- **Money managers discuss outlook at Bloomberg News event**

In the municipal-bond market, everything's going strongly in the right direction: prices have been rising, mutual funds have received new cash from investors for the past 57 weeks, and new debt sales have been gobbled up.

But Guy Davidson, chief investment officer of the municipal-debt business for AllianceBernstein, is still preparing for the risk that his firm's outlook is wrong, given that he and other money-managers are largely in lockstep with expectations for another year of positive returns.

"When everyone's on one side, it gets toppled over pretty easily," he said at a panel hosted by Bloomberg News on Wednesday.

The $3.8 trillion municipal market returned 7.5% last year, the biggest annual gain since 2014, and in January posted its biggest monthly gain in six years. The run-up has pushed yields to the lowest in over six decades, leaving some analysts skeptical of how much more prices can rise.

Davidson said his firm expects "decent" economic growth and isn't anticipating any big moves in yields. But he said he has taken some steps to prepare for a surprise economic downturn, such as adding U.S. Treasuries to portfolios because they tend to outperform during a recession.

At the Wednesday panel, investors from Macquarie Investment Management, Parametric Portfolio Associates, and Columbia Threadneedle Investments expressed similar outlooks for the coming year.

Catherine Stienstra, head of municipal investments at Columbia Threadneedle, said 2020 may be more of a "coupon-clipping" year for investors, meaning returns will be driven more by interest payments than price gains. Still, she said the individual investors who flocked to the municipal market in record numbers last year will likely keep buying the securities to gain the tax breaks or avoid stock-market volatility.

She said she expects such demand to keep supporting the market, even if it isn't as strong as last year. "What drove the strong returns in 2019 are still in place," she said.

Nisha Patel, a director at Parametric, also said the weekly cash influx into mutual funds could slow if investors are deterred by the low yields. Municipal bonds maturing in 10 years yield just 1.2%, half what it was in late 2018, according to the Bloomberg BVAL index. The Bond Buyer's 20-year index is hovering near the lowest since the 1950s.

Patel said she noticed that some new municipal-bond deals this week weren't met with the overwhelming demand that's become routine and left deals far oversubscribed. A move higher in rates would likely lure investors who have been sitting on the sidelines, Patel said.

"The market staying stagnant, where it is, is probably something that we would be concerned about," she said.

Not all muni-bond investors are discouraged. Steve Czepiel, who leads municipal bond portfolio management for Macquarie, said he expects another strong year of returns, saying that rates have room to go lower and that credit spreads can tighten more.

Macquarie is still favorable on high-yield municipals — which last year rallied the most since 2014 — and is being "selective" in what it buys, Czepiel said. He said they prefer deals where there's a lot of issuance to choose from, like health care, so the firm can be choosy.

"The credit markets are in good shape and they will continue to perform due to that technical demand," he said.

Bloomberg Markets

By Mallika Mitra and Amanda Albright

February 13, 2020, 8:02 AM PST

Foreign Yield Seekers Buying Taxable Munis.

Catherine Stienstra, Senior Portfolio Manager and Head of Municipal Investments for Columbia Threadneedle Investments, discusses her current outlook for the muni market. Hosted by Lisa Abramowicz and Paul Sweeney.

Play Episode

Bloomberg Radio

February 13, 2020

Citigroup's New Place to Sell Its Mortgage Loans: Muni Market

- **Government agencies sell $1.4 billion of bonds to buy loans**
- **Bank sees 'new source of financing' for affordable housing**

The voracious appetite for riskier tax-exempt debt is allowing Citigroup Inc. to get affordable housing loans off its books and finance more apartments.

Starting last year, Citigroup, the biggest U.S. affordable housing lender, has underwritten four tax-exempt bond issues for state and local government agencies that used $1.4 billion of the proceeds to buy mortgages the bank made to finance 149 properties with 16,850 units nationwide. The deals gave Citigroup cash to make new home loans.

"We've tapped into a new source of financing for affordable housing by using demand in the muni market," said John Heppolette, Citigroup's head of municipal markets and finance. "More demand ultimately keeps the cost of financing affordable housing down."

The structure is allowing the bank to tap into booming demand for tax-exempt debt, which has driven yields to a more than six decade low and led investors to shift cash into lower-rated securities to generate higher returns.

At the same time, many state and local governments are eager for ways to pump more money into low-cost housing projects. As wages stagnate and real estate prices increase, families nationwide are spending a greater share of their incomes on housing. The U.S. has a shortage of seven million affordable rental homes available to extremely low-income renters, according to the National Low Income Housing Coalition. A household is "cost-burdened" when it spends more than 30% of its income on rent and utilities.

Historically banks and government sponsored entities like Fannie Mae and Freddie Mac have provided capital for multifamily affordable housing. While New York City and state issue bonds for multifamily housing developments, the debt is typically backed by large pools of properties that provide additional collateral, allowing the securities to get higher ratings.

By contrast, Citigroup's deals involve smaller portfolios with a limited cushion to absorb losses and have carried ratings from S&P Global Ratings of BBB and BBB+, two and three steps above junk, respectively. Municipal-bond investors have been eager to take on the risk: high-yield muni funds have drawn in more than $20 billion since the beginning of 2019, according to Refinitiv Lipper US Fund Flows data.

Citigroup sold its multifamily loans to municipal conduit bond issuers like the California Housing Finance Agency, the Arizona Industrial Development Authority and the National Finance Authority in New Hampshire. The conduits purchase the loans by issuing municipal bonds backed by mortgages on the properties, which are also subsidized by the U.S. Low Income Housing Tax Credit program.

The bonds don't directly raise cash for affordable housing projects, but they allow Citigroup to make new loans. Scott Helfman, a spokesperson for Citigroup, declined to comment on how much it made on the sale of the loans.

The bank took the top spot in Affordable Housing Finance magazine's annual lender ranking for the ninth consecutive year in 2019. Citi Community Capital, the firm's community-development arm, made more than $6 billion of loans to affordable rental projects in 2019.

"You start originating that much over a long period of time, it starts to build up significantly," said Heppolette, whose bank is planning more such securitization deals this year.

Last month, Citigroup managed an approximately $480 million bond issue backed by 39 mortgage loans on 43 affordable multifamily rental properties in 12 states. A $455 million series with a 4.125% coupon was priced to yield 2.28% to the 10.6 year average life of the loans, according to Citigroup. The yield was about 0.9 percentage point more than AAA bonds maturing in 11 years. The deal also had a $26.5 million subordinate series that absorbs losses before the senior bonds.

Citigroup's first deal last year was a $172 million issue by the California Housing Finance Authority. The securities yielded about 2.63% to an average life of 11 years, according to Helfman.

The debt was priced attractively because it wasn't a typical muni housing bond structure, said Robert Ellis, a vice president at Kore Private Wealth, which purchased some of the securities. Prices have gone up as investors become more familiar with the structure and money continues to flood into the muni-bond market.

"It's a new creature as far as we know in the muni space," said Margaret Hay, vice president at Kore in New York.

Bloomberg Markets

By Martin Z Braun

February 12, 2020, 10:30 AM PST

We're From the Government and We're Here to Build a Bike Path.

Municipal officials are using eminent domain to take private property for recreational uses.

A handful of farmers in Ohio's Mahoning County are getting an unpleasant lesson in government power at the hands of a local park district. Mill Creek MetroParks, a public agency governed by five unelected commissioners, wants to take over an abandoned railroad line running through about a dozen local farms for a recreational bike path. Last year, when landowners balked at the idea of strangers wandering across their properties, the park district decided to invoke eminent domain and gain right of way.

"I asked the park representatives if there was any way we could negotiate on this, and they told me, 'The time for talking is over. We're taking this property,' " says Ohio state Rep. Don Manning, who tried to intervene on the farmers' behalf. Rep. Manning, a Republican, has sponsored legislation that would limit the use of eminent domain in Ohio.

The practice of government taking land for recreational uses—typically bike lanes, hiking paths and fashionable "rail trails" and "greenways"—is spreading across the country, marking a sharp and troubling expansion of eminent domain. The Takings Clause of the Constitution's Fifth Amendment grants government the authority to seize property to be used for the public good, as long as government pays “just compensation” to the owner. Over the years, the Supreme Court has consistently expanded what is considered a “public good” to justify government seizures. In 2005, for instance, the high court upheld the taking of Susette Kelo’s waterfront home by the city of New London, Conn., so that a local development corporation could build high-end condos and a hotel. The redevelopment was intended to boost property values and increase municipal tax revenues.

Meanwhile, cities and towns across America have in recent years developed an appetite for different types of lengthy, sometimes intrusive hiking and bike paths. Advocates contend that such recreational amenities are vital because they promote alternative forms of transportation. Bike trails “are increasingly being used as a nonrecreational means of transportation, particularly by lower-income residents without access to a motor vehicle,” testified Jason Segedy, director of planning and urban development for Akron, Ohio, in opposition to Rep. Manning’s bill.

Municipal land grabs often result in bitter confrontations. Officials in Sioux City, Iowa, sought to complete a riverfront recreation trail in 2017 by offering Brad Lepper half of what an independent county commission had ruled his property was worth. Rather than pay up in full, the city invoked eminent domain, prompting Mr. Lepper to wage a two-year legal battle. He represented himself for much of the time.

“It can be an intimidating process for a small-business owner to fight this, and many people probably wouldn’t risk it,” Mr. Lepper says. “I took this on myself because I couldn’t afford to run up big legal bills, but I knew the property was worth much more.” Hiring his own appraiser and planning expert, Mr. Lepper ultimately won an $82,500 settlement. Still, it was an uncomfortable experience. “I’m a local businessman. I have to do business here. I didn’t want to fight the city.”

Eminent domain also divides communities. A plan by the town of Swampscott, Mass., to construct a 2-mile trail through the North Shore Boston suburb sparked a yearslong battle pitting officials and some supportive residents against those whose property the path would cross. One property owner, Kim Nassar, published a letter in the local newspaper claiming that she and other opponents had been “vilified and maligned” and branded as “selfish” for lobbying against the project.

Since residents voted in a divisive June 2017 election to dedicate some $850,000 to the Swampscott trail, including an unspecified amount of money for eminent-domain seizures, the town has continued to work to design and fund the project. But an attorney hired by 28 homeowners says he has warned town officials that this battle may be more costly than they anticipate. “There are properties along this path whose value could be substantially diminished,” says Peter E. Flynn. “Juries tend to be sympathetic to property owners if they can afford to fight a case like this in court, and I have seen court awards that can bust the budget of a town.”

The issue also divides elected officials. In 2017 Wisconsin ended the use of eminent domain for recreational projects in a bill signed by then- Gov. Scott Walker, a Republican, after objections from landowners. According to Wisconsin Active Communities Association, a recreational group, 17 bike- and walking-trail projects for which the use of eminent domain was planned have stalled since Mr. Walker’s action. Current Gov. Tony Evers, a Democrat, has sought to re-establish government’s authority to take property in these cases, but so far he’s been blocked by Republicans in Madison. “Somebody else’s recreational opportunity should not be forced on my property,” argues state Rep. Rob Stafsholt, who helped push through the ban.

The Kelo decision provoked a backlash. Some states passed laws restricting eminent domain for economic development. But as local governments, park systems and state agencies become bolder about seizing property for recreational use, don’t be surprised if the next eminent-domain case with national significance involves a bike path in your backyard.

The New York Times

By Steven Malanga

Feb. 14, 2020 5:19 pm ET

Mr. Malanga is senior editor of City Journal.

[S&P: Cyber Risk Management For U.S. Municipal Utilities Should Be Routine And Requires Vigilance And Flexibility]

Key Takeaways

- Developing a cyber defense framework should now be an essential part of risk management planning for U.S. municipal water and wastewater utilities.
- By preparing plans in advance, utilities can ensure continuity of delivery if a cyber incident occurs.
- During a cyber incident, utilities must maintain clear communication with their customers and the general public explaining what is happening and what they are doing about it.
- Recovery planning could generate liquidity problems if not addressed in advance.

S&P Global Ratings believes that cyber risk is an important factor to consider when evaluating credit and has become a key credit focus of risk management for many U.S. municipal utilities. The threat to organizations and the credit impact could get worse before it gets better with the prevalence of cyber breaches and the growing sophistication of cyber criminals. Municipal water and wastewater utilities must develop cyber defense frameworks to prepare themselves for such incidents to ensure continuity of delivery, maintain clear communication with their customers, and have recovery plans in place.

Like other local government counterparts, municipal water and wastewater utilities require trust and transparency with their users: trust that the services will be there and transparency to support decisions about rate increases. Improved technology at the plants can aid in strengthening that trust and transparency and has enhanced data collection, streamlined operations, and improved the user and customer experience. Ironically, however, these benefits also make utilities more vulnerable to cyber crime.

These days, it is easy to become a cyber criminal. On the dark web, there are more ready-made tools and programs available to crack passwords or launch malware, some even with money-back guarantees. In our conversations with utility management teams, we regularly discuss preventative measures, but given the accessibility of technological crime tools, we still find that many utilities are reactive, forced to face these issues as they happen with only miminal advance planning on how to respond.

Cyber breaches pose several risks to municipal utilities. These include the loss of financial assets, personally identifiable information being compromised, and infrastructural and organizational disruptions, not to mention the long-term erosion of public trust. Cyber-preparedness is perhaps even more serious for municipal water and wastewater providers due to the critical nature of this resource: Water is an essential service, and the public has an implicit trust and expectation that such critical infrastructure will be protected and the resource will available when needed.

As we noted in “When U.S. Public Finance Ratings Change, ESG Factors Are Often the Reason” (published March 28, 2019 on RatingsDirect), governance and management issues are the most likely factor behind a rating action across U.S. public finance. Even if a particular disruption is not so serious as to genuinely affect credit quality, headline risk can create different but equally challenging headwinds. The effects of controversies such as a cyber breach and the resultant adverse publicity can weaken citizens’ faith in local elected and administrative leadership should the attack be handled poorly or multiple attacks occur. Scrutiny of decision-makers and their risk management practices is likely to increase.

If a utility needs to increase operating revenues, its only option is generally to raise rates. An erosion of public trust could make that more difficult. If the management team scales back or delays rate adjustments–regardless of the reason–the financial profile could weaken, thereby reducing capital commitments or pushing them out to later years, ironically creating vulnerability to even more operating risks. Part of our ratings analysis has always included an assessment of the management team’s preparedness and resilience in the face of such events and the relative exposure to observable event risks, in addition to ensuring continuity of operations and maintaining financial performance. If, in our view, that becomes diminished after a cyber breach, it very well could be the case that headline risk has a measurable effect on the utility’s credit.

To date, losses from cyber breaches have generally been absorbed by the rated entities’ available liquidity and have not resulted in a material decline in credit quality. However, as cyber risk evolves so rapidly, it may only be a matter of time before more serious repercussions arise. Negative rating actions have occurred in other sectors due to cyber breaches. Clearly, every dollar stolen is a dollar than could have been reinvested as a capital investment or other system improvement. If a successful cyber attack on a rated entity significantly affected the expenses, revenue collections, and liquidity position or caused an entity to require the need for further debt to recover from the cyber event, there would clearly be downward pressure on the rating.

Preventive Measures Can Feel Like Catch-Up Actions, But Are Critical

Cyber criminals can be more adaptive and flexible in their approach than the existing countermeasures against them. Thus, in many cases, security technology is playing catch-up. Therefore, cyber risk mitigation is actually more of a management and governance challenge than a purely technological issue. Identifying the organizational workings, risks, and needs of a utility is the most important step in developing a cyber defense framework. Management’s in-depth understanding of the assets in terms of personnel, data, and the operational aspects of the system is key to identifying areas of risk within the overall utility.

While a number of best practices exist for not only cybersecurity, but also risk management in general, the America’s Water Infrastructure Act of 2018 (AWIA) and subsequent Environmental Protection Agency (EPA) rulemaking now compel all utilities serving at least 3,300 people to create–or for some, to update–a vulnerability self-assessment. “Vulnerabilities” include natural disasters but also “malevolent acts” to demonstrate that management has identified risks and how to be resilient when they occur. These plans should address all facets of the utility, from operations to the back office, and are required to be updated every five years. Finally, management must also establish an emergency response plan to show preparedness for identified risks, then certify or attest to the assessment and emergency response plan once submitted to EPA. We believe this is supportive of long-term credit stability, as risk management in general–and cybersecurity specifically–will become a more explicit part of business as usual for nearly all utilities.

Since the nature of cyber crime is constantly evolving, employee training, preparedness, and awareness must also adapt and evolve. The aging of the workforce across the municipal utilities sector and the looming associated retirements pose risks to new managers, who will have work harder to acquaint themselves with the unique challenges of their utility systems and thus create appropriate security countermeasures for their system and their employees. Obsolete or outdated technology and systems also create cyber vulnerabilities for utilities. Therefore, constant monitoring and updating of systems and isolating and maintaining critical operational systems such as SCADA are generally common but essential starting points of a utility's preparedness planning. Backing up crucial and confidential operational and user data in secure rapid access data storage mediums is another necessary measure. Since the nature of cyber risk is constantly changing, any utility's preparedness plan should also be flexible and ready to adapt.

Detection of intrusions or anomalous activities is another component in the formulation and maintenance of a utility's cyber protection protocols. While managers can use technology tools to detect attempted intrusions, these efforts must be coordinated with robust management plans. These tools, coupled with the vigilance of utility operators toward anomalous activities, can make it more difficult for nefarious actors to gain access to utility systems. Detection and blocking of cyber criminals in a utility's network is extremely important to the organization's brand and maintenance of its public trust. In our current world of ever-evolving cyber criminals, terrorist organizations, and hostile nation-state actors, municipal utilities pose a tempting target for cyber-crime, cyber warfare and cyber terrorism, where risks are low and rewards are high. The protection of critical water and wastewater utilities is therefore not just a local challenge but also a regional or national security concern.

Response Planning Is Key To Credit Stability

Water and wastewater utilities, being essential service providers, must ensure continuity of delivery in the event of a cyber incident. Thus, response planning is critical for them to be able to operate and maintain the trust of their customers. The implementation of previously well-thought-out action plans and stopgap measures is key to the successful navigation of a cyber incident. Examples of such actions that we have seen include the implementation of emergency supply, preparedness for manual system operations, table-top exercises replicating an attack, and the activation of well-maintained back-up data.

Communication and transparency are also key when responding to cyber incidents. Even during severe cyber incidents, the served citizens' implicit trust in their governments is underlined by their expectation that critical components (such as water) continue to function. Despite disruptions, cyber attacks should not affect the accountability of utilities to their customers to provide essential services and doing their upmost to maintain the public's trust and protect personal information. Thus, a robust response plan should include how the breach is represented, how quickly to alert the public, and what management is doing to mitigate the problem. It is also critical for response plans to be regularly reviewed and analyzed to include new approaches and revise procedures in the constantly evolving world of cyber risk.

Recovery Is Easiest When Planned For Before An Actual Attack

Recovery planning is another important component of maintaining public trust in a utility system. It is generally the recovery phase of a cyber incident that poses the greatest credit risk to municipal utilities. The first and foremost credit concern is the cost in terms of damages and resources needed for recovery. The unforeseen costs due to loss of data, compromised systems, recovery consultants(you mean paying them to help after the event?), or deterioration of the affected entities' liquidity position could pose liabilities, which, in some cases, may pressure credit quality and create uncertainty in the municipal market. So we normally ask utilities about the adequacy of their reserves, liquidity, or rainy day funds when considering their exposure to cyber risk.

The loss of constituent trust is another factor as weak public support may weaken the ability of the affected entity to raise the funds needed to rebalance the system. There may also be calls for the removal in the utility's management. Therefore, thoughtful response planning is also key to the maintenance of credit quality and public trust for municipal utilities. Response activities must be well coordinated with local and federal authorities and the response plan should include steps regarding communications with them. The lack of response preparedness and transparency in cyber incidents not only erodes public confidence but also makes it more difficult for local and federal law enforcement to track and combat future risks and breaches.

Ultimately, the heightened speed of communication and the rapid globalization of the cyber realm mean that state and local government entities, which previously were only concerned with their local service areas and thus somewhat insulated, are now part of the global risk environment. The importance of these public systems in the fabric of our critical infrastructure, coupled with their limited resources, makes them tempting targets for cyber criminals and other hostile global actors. These factors, coupled with the localized nature of utilities in the U.S., make cyber security a unique operational and credit challenge for water and sewer utilities.

This report does not constitute a rating action.

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Ransomware Attack on Hospital Shows New Risk for Muni-Bond Issuers.

- **The attack in part led to a breach of a covenant agreement**
- **The hospital spent $1 million in response to the attack**

Hackers have finally done what bond issuers may have feared most from cyber criminals.

A ransomware attack on Pleasant Valley Hospital in West Virginia was partly responsible for the hospital's breach of its covenant agreement, according to a notice to the hospital's bondholders from the trustee, WesBanco Bank. It appears to be the first time a cyber attack triggered a formal covenant violation, according to research firm Municipal Market Analytics.

The virus entered the hospital's system via emails sent 10 months before the cyber criminals asked the hospital for money, said Craig Gilliland, the hospital's chief financial officer. The information the criminals held for ransom did not contain patient data or confidential data, so it was "more of an annoyance," he added.

Because of the attack, the hospital was forced to spend about $1 million on new computer equipment and infrastructure improvements, Gilliland said. That cost, along with declining patient volume, caused the hospital's debt service coverage for the fiscal year that ended on Sept. 30 to fall to 78%, below the 120% the loan agreement requires, according to the material notice to bondholders.

Continue reading.

Bloomberg

By Mallika Mitra

February 5, 2020, 7:11 AM PST

Fitch Rtgs: Medicaid Changes Will Affect States, NFP Healthcare Providers

Fitch Ratings-New York-06 February 2020: Recent regulatory actions from the US federal Centers for Medicare and Medicaid Services (CMS) could have fiscal and credit repercussions for state governments and those reliant on state funding, particularly not-for-profit (NFP) healthcare providers, Fitch Ratings says. The proposals illustrate the Trump administration's efforts to make notable changes to Medicaid, even without legislative approval given the divided control of Congress. Collectively, Medicaid's expenditures account for approximately 20% of states' non-federal funds spending, according to the National Association of State Budget Officers. Medicaid covers nearly 1 in 5 Americans, though commercial payers are more significant in terms of patient net revenues for providers.

CMS recently issued two regulatory notices opening the door to potentially significant changes to Medicaid. The Healthy Adult Opportunity initiative (HAO) allows states to transition to block grants or per capita cap grants for certain beneficiaries, effective immediately. The Medicaid Fiscal Accountability Regulation (MFAR), which is in the midst of the rulemaking process and at least several months from implementation, could upend how states finance their Medicaid costs.

HAO is optional for states and provides guidance on applying for Section 1115 Waivers to extend coverage to adults under 65 not otherwise eligible for Medicaid, with a per capita or block grant cap on federal contributions. Under current law, the federal government matches state Medicaid spending at varying percentages on an open-ended basis. An HAO per capita or block grant shifts cost risk to states. In return, states receive flexibility including cost-sharing requirements with beneficiaries, work requirements or limiting prescription drug coverage.

Capping federal Medicaid contributions, even for a subset of beneficiaries, poses risks to state budgets and those entities reliant on state funding, including local governments and providers. States would need to find revenue or cost savings, either in Medicaid or elsewhere, to offset reduced federal contributions. Since CMS notes the flexibility available under HAO is already available via separate waivers, the fiscal benefits to states are unclear.

Fitch considers CMS's proposed MFAR as potentially more disruptive than HAO to credit quality. MFAR affects how states finance their share of the Medicaid program. Various state organizations including the National Governors Association and the National Association of Medicaid Directors have suggested MFAR represents a material change to current CMS policy, creating uncertainty for states and providers.

Among other changes, MFAR revises standards for approving healthcare-related taxes in ways that could limit states' ability to use this important Medicaid funding source. The Medicaid and CHIP Payment Access Commission (MACPAC) reports 49 states and the District of Columbia use such taxes, and the General Accounting Office reported in 2014 that provider taxes made up at least 10% of states' Medicaid contributions. MACPAC reports states spent $230 billion on Medicaid in federal fiscal year 2018.

The American Hospital Association, in an analysis conducted with Mannatt Health, estimated MFAR could reduce total Medicaid spending nationally by $37 billion and $44 billion annually, or 5.8% to

7.6%, and by $23 billion to $30 billion for hospitals alone. States and, to some extent providers, would respond to MFAR's implementation with measures to mitigate the negative fiscal implications. For both HAO and MFAR, Fitch anticipates states' credit quality would be less directly affected, given their broad ability to manage spending and revenues, although short transition times could complicate budget effects. Credit quality for those providers reliant on state funding could be more at risk, as they have relatively less fiscal flexibility. This is particularly true for NFP healthcare providers that have higher Medicaid exposure.

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[Satellites Are Helping the Municipal-Bond Market Assess Climate Risk.]

Investment firms are using spatial data mining to visualize dangers.

The $3.8 trillion municipal-bond market has found a new tool in its effort to understand the impact of climate change: the array of satellites orbiting high above Earth.

Assessing climate risks is a particularly vexing problem given that U.S. state and local governments tend to give investors information that's often too little or just too late. But the use of geospatial data and information from sources like Google Earth could help municipal-bond investors evaluate and price the risks posed from a warming climate, rising sea levels and natural disasters.

The deployment of spatial technology in the municipal market advanced in January when credit-ratings company S&P Global Ratings completed an analysis of U.S. water utilities using data from National Aeronautics and Space Administration satellite missions. Other investment firms say they're starting to focus on geospatial information as a way to evaluate climate risks as well.

Continue reading.

Bloomberg Green

By Amanda Albright and Mallika Mitra

February 6, 2020, 2:00 AM PST

[S&P U.S. Higher Education Rating Actions, 2019]

S&P Global Ratings affirmed 88% of college and university ratings reviewed in 2019. We lowered 17 ratings and raised 14. Notably, of the schools upgraded, three are rated in the speculative grade category (Western Illinois University, Eastern Illinois University, and Sweet Briar College), and three moved from one rating category to another: Boston University, Villanova University, and the University of Alabama Huntsville were all upgraded to 'AA-' from 'A+', due to strengthening credit profiles, exemplifying the intensifying bifurcation within the sector. Additionally, the sector saw over twice as many negative outlook revisions (20) as it did positive outlook revisions (7).

View the Rating Actions.

5 Feb, 2020 | 18:25

High-Tax States' Bonds Are So in Demand That Ratings Don't Matter.

- **'To boil it down, it's 99.999% because of the SALT cap'**
- **California, New York yields holding below the AAA benchmark**

There's so much money chasing after the bonds sold by America's high-tax states that buyers don't seem to care too much about what credit-rating companies think.

The heavy demand overall has driven municipal yields to their lowest in more than six-decades. And with rates so low, the yield penalties that would typically differentiate a deeply indebted state from a thrifty one have become little more than rounding errors that in some cases contrast with their standing in the ratings pecking order.

California's general-obligation debt, for example, is yielding about 1 basis points less than the AAA benchmark, even though the state is rated as many as four steps below that, according to data compiled by Bloomberg. New York, one step below AAA, is paying about 8 basis points less than top-rated borrowers. Over the past year, New Jersey's yield premium has been cut nearly in half even though its rating hasn't changed. Connecticut's is roughly a third of what it was.

By contrast, bonds issued by AAA rated Texas and Florida, where there's no state income tax, pay above-benchmark yields.

This dynamic shows how dramatic the demand has become for tax-exempt securities since President Donald Trump's 2017 tax law limited state and local deductions. That change drove investors in high tax-states like California, New York and New Jersey into municipal bonds as an alternative way to drive down what they owe.

"To boil it down, it's 99.999% because of the SALT cap," said James Iselin, portfolio manager at

Neuberger Berman Group LLC in New York. “Because there’s is so much demand in the market — there is less of a credit differentiation that the market is making.”

Bloomberg Markets

By Danielle Moran

February 6, 2020, 10:56 AM PST

States Take the Reins in Resilience Planning.

Governors say states are taking steps to assure their long-term resiliency in the face of worsening climate change—and in the absence of sweeping federal action.

In the absence of strong federal actions to address climate change, states are beginning to implement their own measures to ensure long-term resiliency, governors said Sunday at the National Governors Association winter meeting in Washington, D.C.

“Everyone says, ‘It can’t happen here,’ until it does happen here. And it can happen in any one of our states,” Janet Mills, the governor of Maine, said during a panel discussion on state-level resilience planning. “I think we all sat back for years and said, ‘If something happens, FEMA will help us out.’ We need to start this at home.”

Maine has seen firsthand evidence of climate change, including extensive flooding and the looming loss of what Mills called “working waterfront.” To prepare for future events, Mills said, the state has undertaken a host of “decisive actions” aimed at mitigation, including the implementation of an electric vehicle rebate program, a goal to achieve statewide carbon neutrality by 2045. The state has also launched a “100,000 heat pump initiative” designed to help residents ease their dependence on fossil fuels.

Continue reading.

Next City

By Kate Elizabeth Queram,

FEBRUARY 9, 2020 02:57 PM ET

The Trillion Dollar Question: Can Cities Safely Navigate the World of Private Investment?

In 2008, then-Chicago Mayor Richard M. Daley, famous for privatizing public infrastructure in order to secure short-term revenue sources, made the worst deal of his career. He leased 75 years of parking meter revenues to an investor group that included Morgan Stanley and the Abu Dhabi Investment Authority in exchange for a $1.15 billion upfront payment.

The Windy City spent that money in just three years as it sought to plug municipal budget holes during the throes of the Great Recession. However, under the terms of the deal, the city is on the hook for the “full value” of the parking revenue. If the parking authority doesn’t increase street parking rates in line with inflation or if the city suspends meters for a Cubs victory parade, then the city owes the difference to that investor group.

By squandering so much long-term revenue and handcuffing the city to onerous contractual terms, Chicago’s parking arrangement earned the dubious distinction of a “worst practice” from an Illinois government watchdog.

Continue reading.

NEXT CITY

by GREGORY SCRUGGS

FEBRUARY 8, 2020

Muni Bonds Go Wild. Could 1% 10-Year Yields Be Far Behind?

The insatiable demand for U.S. state and local government debt may face a big hurdle.

The $3.8 trillion U.S. municipal bond market, sometimes called a sleepy asset class, has been partying awfully hard lately.

Consider that investors poured $1.8 billion into muni mutual funds in the week through Jan. 29, the 56th consecutive week of inflows, according to Refinitiv Lipper US Fund Flows data. Then, on Jan. 31, the biggest high-yield muni exchange-traded fund, the VanEck Vectors High-Yield Municipal Index ETF, drew in $150.2 million, the largest one-day increase in assets since inception in 2009. The amount of state and local debt on the books of Wall Street banks has dwindled to the least since late 2014. Overall, the market returned 1.8% in January, its strongest month in six years.

Continue reading.

Bloomberg Markets

By Brian Chappatta

February 5, 2020, 4:00 AM PST

Citigroup Bucks Herd in Call for ‘Intense, Prolonged Rally’ in Muni Market.

- **The investment bank says munis may return more than 8% in 2020**
- **Tax-exempt municipal bonds gained more than 7% last year**

Citigroup Inc. analysts are standing apart from the Wall Street pack by predicting that the municipal-bond rally may be gaining steam.

Vikram Rai, Jack Muller and Vedanta Goenka, who track the state and local government debt market for the bank, said in a note to clients that the securities may return more than 8% in 2020 as cash continues surging into the market. That would come after tax-exempt bonds gained more than 7% last year, their biggest annual jump in five years.

“The ongoing intense, prolonged rally, has led to gluttonous demand for tax-exempt paper, which has engendered strong performance, and is leading to more gluttonous demand,” the analysts wrote.

The bullish forecast from Citigroup, the second biggest underwriter, stands in contrast to widespread expectations on Wall Street. Late last year, analysts at firms including Barclays Capital, UBS AG and Morgan Stanley predicted that the market was poised for more muted gains, given how low yields had become.

Since then, however, prices continued to rally as the amount of cash being invested outstripped the volume of new tax-exempt bonds being sold and the coronavirus outbreak increased demand for the safest assets. That drove the securities to a 1.8% gain in January, the biggest one-month advance in six years, according to the Bloomberg Barclays index. Yields are at their lowest in over six decades.

Price gains slash yields to lowest in over six decades

Citigroup’s forecast is based in part on the behavior of individual investors who are by far the biggest buyers of municipal debt. As long as the market continues to gain, they tend to keep sending in their cash, creating a self-reinforcing cycle. While that can also exaggerate the impact of a downturn, the bank’s analysts said they “do not see a sell-off on the horizon.”

Other forecasts are more muted. Even after January’s gains, Barclays analyst Mikhail Foux said he still expects investment-grade state and local government bonds to return 2% to 2.5% this year. BlackRock Inc.’s Sean Carney is forecasting similar sized gains, saying that other months “are not as friendly as January has been.”

But based on its expectation for inflows to municipal bond funds, Citigroup anticipates average gains of about 8.2% across various maturities, with nearly 11% returns on 30-year bonds.

Rai said in an interview that he expects prices will inch up as the year goes on. “It’s simple supply and demand fundamentals,” he said.

Bloomberg Markets

By Danielle Moran

February 4, 2020, 10:38 AM PST

Virus Outbreak Not Impacting Muni Credit Yet, Hilltop's Kozlik Says.

Tom Kozlik, Hilltop Securities head of municipal strategy, discusses the potential impact of the coronavirus outbreak and the proposed infrastructure legislation currently before Congress on the municipal bond market. He speaks with Bloomberg’s Taylor Riggs on “Bloomberg Markets.”

Watch video.

Bloomberg MarketsTV Shows

February 5th, 2020, 10:20 AM PST

Winds Driving Muni-Bond Rally Are Blowing Hardest in Illinois.

- **No state but Texas faces as big a supply gap over next month**
- **With bonds near junk, Illinois also gains from hunt for yield**

The forces that are driving the municipal-bond market rally are especially strong in Illinois.

Over the next 30 days, agencies in the state will pay off about $1.3 billion of debt, more than eight times as much as is currently scheduled to be sold, according to data compiled by Bloomberg. While that gap may narrow as more bond offerings are announced, nowhere except Texas currently faces as large a mismatch between supply and demand. That's a positive sign for Illinois debt, which this year has already outperformed every other U.S. state tracked by Bloomberg as rock-bottom interest rates cause investors to snap up higher-yielding bonds.

The wide gulf between the cash sloshing around — from debt payments, new investments into mutual funds, and those seeking havens from stock market volatility — pushed the municipal-securities market in January to the biggest one-month gain in six years. Those same dynamics appear poised to continue in February, when bondholders will receive even more in principal and interest payments than they did last month.

"The technicals are way, way overwhelming," said George Huang, an analyst who follows state and local government debt for Wells Fargo & Co. That "would point to further tightening of spreads and yields across all munis and also for comparatively yieldier Illinois bonds."

The broader rally has cut municipal-debt yields to the lowest in more than six decades, fueling interest in bonds with higher payouts. That has helped fuel the outperformance for Illinois, whose rating three years ago was at risk of being cut to junk because of the government's large debt to employee pension funds and the gridlock the former Republican governor encountered in the Democrat-controlled legislature.

The end to the political divide since Democratic Governor J.B. Pritzker took office last year has also contributed to the state's outsize gains. The difference between the yields on Illinois's 10-year bonds and those with the highest credit ratings — a key measure of the perceived risk — has narrowed to a little over one percentage point, the smallest since at least 2013 and down from more than three percentage points in 2017 at the height of a long-running impasse over the budget, according to data compiled by Bloomberg. The yield-penalty on Illinois bonds is still the highest of the 20 states tracked by Bloomberg.

Even so, Illinois's returns have been driven more by the broader dearth of new bonds than by the government's fiscal health, said Dan Solender, head of municipal securities investments at Lord Abbett & Co.

"There is very limited supply," Solender said.

Bloomberg Markets

By Shruti Singh

February 5, 2020, 10:30 AM PST

New ETF Created to Tap Demand for Muni Debt With Social Investing.

- **Fund appears to be first of its kind aimed at the two markets**
- **Will focus on muni debt that finances sustainable development**

VanEck plans to wade deeper into sustainable investing with the launch of what appears to be the first-of-its-kind municipal-bond exchange traded fund.

The asset-management company on Feb. 5 filed to register an actively-run Sustainable Muni ETF that will focus on investment-grade state and local government debt from "issuers with operations or projects helping to promote progress towards sustainable development." The fund will use the United Nations' Sustainable Development Goals, which aim to encourage sustainable cities and promote responsible consumption, to help make investment decisions, the filing says. No other muni ETF of that profile has so far been set up, according to data compiled by Bloomberg.

The plans for the fund come amid growing interest in both the $52 billion municipal ETF industry and investment strategies that promote the public good. The $3.8 trillion municipal-bond market, which finances things like public transit systems and green-energy start-ups, has seen firms like Brown Advisory and Neuberger Berman add mutual-fund products focused on investments that are perceived to have a positive impact on society.

The VanEck fund would also take a rules-based approach to choosing its investments, the filing says. It will incorporate ratings from independent research firm HIP Investor Inc., which measures investments' impact on society. Those investments could include bonds for affordable housing, hospitals and green spaces, the filing says.

VanEck municipal portfolio manager Jim Colby will manage the fund, the filing says.

Bloomberg Markets

By Amanda Albright

February 6, 2020, 7:53 AM PST

Tough-to-Disrupt Municipal Market Attracts Blockchain Developer.

- **ConsenSys buys Heritage Financial Systems; Terms undisclosed**
- **Firm seeks to ease issuance of tokenized bond offerings**

The municipal-bond market, with roots dating back to an 1800's New York City canal project, has a reputation for being stuck in a different century.

The $400-billion-a-year market, used by some 50,000 U.S. issuers, is known for small-sized deals that sometimes don't trade again for years after they're sold. Financial filings are often late and outdated. And hiccups with technology and human error can sometimes cause officials to forget to make bond payments on time.

That's why ConsenSys, a blockchain-application developer started by Ethereum co-founder Joseph Lubin, sees an opportunity to expand into the $3.8 trillion state and local debt market. The Brooklyn-based firm said on Tuesday that it acquired the broker-dealer Heritage Financial Systems, betting that governments can more efficiently raise funds and gain local investors by tokenizing municipal bonds on its Codefi platform.

Continue reading.

Bloomberg Cryptocurrencies

By Amanda Albright

February 4, 2020, 6:00 AM PST

ConsenSys Tokenizing $3.8T Municipal Bond Market.

Improving finance one bond at a time.

ConsenSys announced the acquisition of Heritage Financial Systems, an American broker-dealer, in a bid to tokenize the $3.8 trillion municipal bond market and improve one of the most tradition-bound assets in finance.

Is There a Blockchain for That?

Emma Channing, a coordinator of the deal, told Bloomberg that implementing blockchain technology for the municipal bonds sector “is a great use case.” The thesis follows that blockchain technology, along with a host of other incoming technologies, will help digitize critical infrastructure. From finance, real estate, gaming, and so on, every industry looks ripe for renovation. This is especially true in the traditional debt market.

Municipal bonds move slowly and tend to be outfitted with inefficient tools which are prone to human error. Defined as debt securities, state institutions sell municipal bonds to investors. The capital raised is used to build roads, support schools, and other public projects.

ConsenSys’ Attempt at “Mini-Bonds”

Channing may be correct, blockchain technology could shine in this environment. Clearly, ConsenSys sees real promise in combining the two businesses too. The specific implementation would tokenize the municipal bonds on ConsenSys’ Codefi platform. This would allegedly make it easier to sell so-called “mini bonds.”

Such mini bonds would be no different than what can be seen in the wider securities space. By tokenizing bonds, stocks, and equity, crypto entrepreneurs claim that inefficient markets could be made much quicker. Fintech outfit Securitize is doing exactly this, for example. And, as the name suggests, these digital assets could be parceled into even smaller pieces.

There is also an opportunity for further innovation once such assets are placed on a blockchain. In the bond sector, ConsenSys said that portions of how bonds are bought, sold, tracked, and distributed could be executed automatically.

The global fintech lead of ConsenSys, Patrick Beraducci, also pointed out that mini bonds may improve engagement between community members and their local government. Still, traction in this space has been unimpressive.

Neighborly, a non-crypto startup that worked to crowdsource bond underwriting, told its employees last year that it had run out of money. The bad news came two years after they had underwrote a massive debt sale for the city of Cambridge, Massachusetts.

Only time will tell if Neighborly failed in substance or in execution. With the latest ConsenSys acquisition, however, onlookers may have their answer soon enough.

Crypto Briefing

by Liam Kelly

Feb. 4, 2020

Understanding the New Wave of Green Debt.

Municipal debt markets can cater to everyone from a conservative investor looking for principal protection while earning enough to keep up with inflation to a moderate risk-taker who might be looking for high returns.

The new wave of green municipal debt instruments has many investors talking and potentially looking to make them part of their portfolio. The Municipal Securities Rulemaking Board (MSRB) states that green bonds are fixed-income debt instruments like any other bond. They offer a stated return and a promise to use the proceeds to finance or refinance, in part or fully, new or existing sustainable projects.

Generally, green bonds fund environmental, social and governance improvements or projects, and are issued by the public, private or multilateral entities to finance projects related to a more sustainable economy and that generate identifiable climate, environmental or other benefits. These projects may include renewable energy and energy efficiency projects, clean public transportation, pollution prevention and control, conservation, sustainable water and wastewater management, and green buildings that meet internationally recognized standards and certifications.

In this article, we will take a closer look at the rise of green debt issuance by public agencies and how an investor can meet his/her long-term investment goals while staying environmentally responsible and aligning with their social values.

Continue reading.

municipalbonds.com

by Jayden Sangha

Feb 05, 2020

Muni Bond Deals Continue to Help Global Green Issuance.

(Bloomberg) — American cities borrowing to fund environmentally-friendly projects continue to help drive green bond issuance, data compiled by Bloomberg show.

Green muni bond sales — including deals from San Francisco's Public Utilities Commission, New York City's Metropolitan Transportation Authority and Maine's Governmental Facilities Authority — were about $1 billion in January 2020, up from $972 million in December. Issuance reached approximately $9.8 billion in 2019, the second-biggest annual issuance total in data going back to 2013.

That helped push the global tally of corporate and government green bonds issued during the month to about $18.8 billion, in line with the $18.4 billion raised in January last year, according to Bloomberg compiled data.

Companies — mostly European power utilities — issued about $4.5 billion in green debt, a drop from about $9.7 billion raised in the first month of 2019, according to data compiled by BloombergNEF. Germany's E.ON SE sold $1.1 billion in green bonds to help fund sustainable infrastructure and energy efficiency projects. Portugal's EDP, which aims to slash emissions by 40% by 2030, raised about $800 million.

Bringing More Buyers

For New York's MTA, which issued $924.8 million in green bonds in January, adding a green label brought more buyers to the table, said Patrick McCoy, the issuer's director of finance. "Strong interest resulted in great results for the MTA," he said in a telephone interview Monday.

While companies in the U.S. didn't issue green bonds in January, high-profile deals like Verizon Communications Inc.'s $1 billion 2019 sale will encourage others, according to Moody's Investors Service. The bond grader expects issuance to hit $300 billion in 2020.

"There's growing demand for responsible investment strategies broadly speaking and for a lot of them green bonds fit in," James Rich, senior portfolio manager and chair of the sustainable investment committee at Aegon Asset Management, said in an interview Monday. "They are kind of a natural place for investors to look."

More sovereign issuers are expected to issue green bonds in the wake of and Chile, which sold debt in euros and U.S. dollar last month. Insight Investment, with about $900 billion in assets, is contacting governments in both emerging and developed markets directly to express an interest in buying more green bonds, said Josh Kendall, senior environmental, social and governance analyst at the firm.

Bloomberg

by Caleb Mutua and Mallika Mitra

February 7, 2020

[New MSRB Analysis Finds that Retail Investors Tend to Purchase Municipal Bonds with Lower Coupons More Often Than Institutional Investors.]

[Read the report.]

Regulator Warns of Interest-Rate Risk Retail Investors Take With Low-Coupon Munis.

MSRB study shows retail investors purchase more 3-3.5% coupon bonds, institutional buy 5%

Retail investors purchase more municipal bonds with lower coupons than institutional investors do, setting themselves up to take a hit if interest rates rise, a regulatory organization found in a recent study.

Earlier this week, the Municipal Securities Rulemaking Board released a study showing that more than half of retail investor purchases involved bonds with a coupon of 3% to 3.5%. Most institutional investors bought bonds with a 5% coupon. The analysis was based on sales of bonds with maturities of 15 years or longer between May 1 and Oct. 1 last year.

In the report, the MSRB highlights the interest-rate gamble that retail investors are taking if they sell their bonds before they mature. If rates rise, bond prices fall. The smaller the coupon, the more vulnerable the bond is to rate volatility.

"In particular, a potential future rise in interest rates could have a material impact on investors' ability to sell the bonds at market price, should they want to sell the bonds prior to maturity," the report states.

In addition, the market discount is more likely to fall outside a de minimis threshold and be taxed at the ordinary income tax rate rather than at the capital gains rate, which would likely drive the bond price lower.

The report is a way for the MSRB — a self-regulatory organization that focuses on rule-making, education and transparency — to help investors navigate the muni bond market, said John Bagley, chief market structure officer for the MSRB.

"We want to make sure investors have all the information available at the time they're making these decisions," Mr. Bagley said. "If you're looking at [low-coupon] bonds, recognize that this is a unique risk to this type of structure."

Ronald Bernardi, chief executive of Bernardi Securities, endorsed the MSRB report because it highlights the risks surrounding low-coupon bonds.

"I like that the MSRB puts these pieces out," Mr. Bernardi said. "Bonds are complicated. The report is good. It's basic. That's the audience the MSRB is addressing. There are a lot of sophisticated investors out there who are buying bonds themselves."

But he hopes the MSRB study doesn't stigmatize low-coupon bonds.

"My one concern with this is don't conclude from it that a bond with a 3% to 3.5% coupon, within the context of the entire portfolio, is necessarily a bad thing," he said.

Mr. Bagley said the report is not meant to indicate that investors are being harmed by purchasing low-coupon bonds or that they should avoid them. The report notes that buyers may want to take advantage of lower premiums and potentially higher yields.

But financial advisers who recommend discounted bonds also need to know the risk, Mr. Bagley said. “They should be aware of it and telling their clients about this risk when their clients buy bonds.”

Financial advisers already have a good grasp of the ups and downs of the bond market, said Dennis Nolte, vice president at Seacoast Investment Services. He recently attended a Financial Planning Association of Central Florida meeting about tax-free income, where municipal bonds were a topic of discussion.

“There aren’t too many folks who have just fallen off the turnip truck,” Mr. Nolte said. “The garden-variety financial adviser has a grasp of the risks in the market when you’re buying an investment with a long duration.”

INVESTMENT NEWS

BY MARK SCHOEFF JR.

February 5, 2020

New ETF Created to Tap Demand for Muni Debt With Social Investing.

(Bloomberg) — VanEck plans to wade deeper into sustainable investing with the launch of what appears to be the first-of-its-kind municipal-bond exchange traded fund.

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VanEck municipal portfolio manager Jim Colby will manage the fund, the filing says.

Bloomberg

Amanda Albright

February 6, 2020

EPA Announces First WIFIA Annual Report Highlighting $3.5 Billion in Infrastructure Funding.

WASHINGTON (February 6, 2020) — Today, as part of the U.S. Environmental Protection Agency's (EPA) 50th anniversary celebration, the agency released its first-ever Water Infrastructure Finance and Innovation Act (WIFIA) program annual report. Through 2019, the WIFIA program has financed more than $3.5 billion in loans, which has saved borrowers $1.2 billion dollars and has helped improve water quality for more than 20 million Americans.

"The WIFIA program's success is a key component of President Trump's efforts to modernize our nation's aging infrastructure, strengthen public health protections, and create jobs," said EPA Administrator Andrew Wheeler. "I have seen first-hand the impact this program has had on local communities in just a short amount of time. The WIFIA program has proven to be a tremendous tool in achieving environmental protections and fostering economic growth in communities across the country."

Established by Congress in 2014, the WIFIA program is an EPA federal loan and guarantee program focused on helping meet the growing water infrastructure needs in communities across the country. The program provides long-term, low-cost supplemental credit assistance to creditworthy drinking water and wastewater projects of national and regional significance.

WIFIA loans can finance a wide range of drinking water and wastewater projects, including traditional drinking water and wastewater treatment plants and conveyance systems, water recycling and desalination plants, drought prevention and mitigation projects, stormwater management, green infrastructure, non-point source pollution control and source-water protection. Eligible WIFIA borrowers include local, state, tribal, and federal government entities; partnerships and joint ventures; corporations and trusts; and State Revolving Fund programs.
Through 2019, the WIFIA program has closed 14 loans ranging in size from $20.7 million to $699 million. Together, WIFIA has provided $3.5 billion in loans to help finance more than $8 billion for water infrastructure projects while creating more than 15,000 jobs. Of those projects, 57 percent directly support Clean Water Act and Safe Drinking Water Act compliance.

In 2019, EPA invited 38 new projects to apply for WIFIA loans, totaling approximately $6 billion to help finance over $12 billion in water infrastructure investments. These projects will help support key agency priorities, including reducing lead and emergent contaminants and developing water reuse and recycling capacity. Together, the selected projects will improve water quality for 24 million people in 18 states.

For more information on the WIFIA program and to read the WIFIA annual report, visit: https://www.epa.gov/wifia.

02/06/2020

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Fitch Rtgs: Coronavirus Places Limited Pressure on Airport Revenues

Fitch Ratings-New York-31 January 2020: Most US, EMEA and LATAM airports are able to absorb the effects of air traffic interruptions due to the Wuhan coronavirus, says Fitch Ratings, although a prolonged suspension of Chinese air travel will depress passenger volumes and may pressure airport revenues. While Fitch believes airports are well positioned to handle such event risks, the situation is rapidly evolving, as a growing number of countries with exposure to this latest outbreak are causing additional flight cancellations and border closures. The duration of the health crisis and associated travel restrictions will determine if the virus will have longer-lasting effects on business and leisure air traffic.

Travel bans will primarily affect large hub and international gateway airports but these airports should be able to absorb a short-lived reduction in air traffic as they have strong cash reserves and can adjust rates to recover costs. As more companies suspend Chinese operations and airlines cancel and reduce flights, air traffic reductions may take longer to recover to pre-epidemic levels. A stall in overall traffic growth or a sustained dip in volumes could pressure airports to take defensive actions to protect their cash flows or reserves.

Flight cancellations by carriers, due to reduced passenger demand because of government imposed travel restrictions or negative travel sentiment, will slow traffic growth. However, the effects on costs and operations of most airports are expected to be minimal because of the stronger financial profiles of international airports, as air traffic is generally geographically diversified at these airports.US airports with non-stop service to China, namely San Francisco, Los Angeles, Seattle, Chicago O'Hare, and JFK, currently do not have a high dependence on this market segment, typically less than 10%, and China is not a major market pair for any US airport. A prolonged service interruption could certainly constrain growth compared with expectations and some airport revenue streams could face pressure such as terminal concessions.

Currently we expect the effect on European airport traffic to be temporary and limited due to low exposure to Asia. Direct flights to China constitute a small share of EMEA airport traffic, ranging from 0.2% to around 6.0%. The APAC region in general represents from 1.5% to 14.0% of total traffic. Some airlines such as British Airways and Lufthansa have suspended all flights to and from China, whereas others such as Hainan Airlines and Air France-KLM plan to cut the frequency of flights.

As a developing market, China's air traffic has grown faster than most markets, although growth slowed slightly in 2019 due to trade tensions with the US. Given the number of Chinese travellers increased dramatically since the SARS outbreak in 2003, the effect of travel bans and flight suspensions on air traffic to and from the country will have a greater effect than past outbreaks. Nevertheless, based on past event risks, including viral outbreaks, air travel should rebound, but at this point the timing remains uncertain.

Fitch Ratings: Driverless Cars Largely a Plus for Toll Roads; Managed Lanes Vulnerable

Link to Fitch Ratings' Report(s): The Effect of Automated Vehicles on Toll Roads (Automated Vehicles Are Likely Positive but Congestion Reliever Toll Roads Are Most Vulnerable)

Fitch Ratings-New York-03 February 2020: Though likely over a decade away from widespread usage, automated vehicles (AVs) will have a transformative effect on travel and traffic patterns for toll roads, according to Fitch Ratings.

While the effect on ratings is still too early to gauge, toll roads will likely benefit over time for numerous reasons. Perhaps chief among them will be an increase in vehicle miles traveled. "Commuters will now be able to complete other tasks en route if they don't have to drive, which makes longer journeys more tenable," said Scott Monroe, Director at Fitch Ratings. "More trips are also expected since empty cars can reposition themselves and individuals who cannot drive a conventional vehicle will have improved mobility."

However, the advent of AVs could be potentially disruptive and make forecasting future toll revenues more difficult since there are also competing factors that could decrease vehicle miles traveled. AVs could encourage more carpooling, resulting in fewer individual trips.

Toll roads with no viable competing routes, such as monopolistic bridge systems and large expressways, are difficult to avoid, making them the least susceptible to revenue loss from AVs. Conversely, congestion relievers like managed lanes are the most vulnerable. A driver will choose to use a toll road if the driver's value of time (VOT) saved is greater than the cost to pay a toll. AVs reduce VOT because a passenger's time is freed up to complete other tasks instead of driving. Even with an increase in the number of trips, "Since AVs decrease the value of time the willingness to pay tolls for a faster trip declines," said Monroe.

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Additional information is available on www.fitchratings.com

Fitch Rtgs: US Healthcare Policy Proposals Will Weigh on NFP Hospitals

Fitch Ratings-New York-03 February 2020: Healthcare is a major 2020 US presidential election issue, and some leading proposals, if implemented, would have considerable credit implications for not-for-profit (NFP) hospitals, says Fitch Ratings. The outcome of the election will likely have significant ramifications for healthcare regulation and spending, although the success of any plan is dependent upon a party's control of both the White House and Congress.

Federal policy could take very different paths due to deep political polarization. In addition to bipartisan views, there are philosophical differences regarding healthcare policy among Democratic presidential candidates. Democratic proposals including "Medicare For All", "Medicare For All Who Want It", and "The Public Option" are top of mind as Iowans caucus today.

We believe the chances of a “Medicare For All” plan becoming the law of the land during the next presidential term are remote due in part to these divisions. Not only is private health insurance popular among many Americans but the costs of “Medicare For All” would be huge, making it difficult to garner support in Congress. Focus on the costs of any federal healthcare proposal will be intense, given projections of an increasing federal budget deficit reaching $1.0 trillion this fiscal year, according to the Congressional Budget Office.

Healthcare is a considerable portion of the economy, representing nearly 18% of GDP in 2018, according to the US Centers for Medicare and Medicaid. The federal government shoulders much of this cost, spending nearly $1.1 trillion on Medicare, Medicaid, the Children’s Health Insurance Program, and veterans’ medical costs, out of a total federal outlay of $4.1 trillion in federal fiscal year 2018.

The “Medicare For All” proposal essentially replaces commercial insurance payments with Medicare rates and would be an unambiguous credit negative for NFP hospitals. Only the most efficiently operated hospitals reportedly break even on Medicare rates. Effectively all profit margin is earned from commercial/managed care insurers. If the private insurance market were downsized significantly or eliminated altogether, hospital operating margins would be slashed, and unless Medicare reimbursement rates were revised upward, most hospitals would begin to run deficits.

A proposal being offered by more centrist Democrats is to keep the Affordable Care Act (ACA) and reintroduce the public option, which was part of the initial ACA proposals. The credit effect on NFP hospitals would depend on how any potential public option is structured. If set up to add competition to the health insurance market without meaningfully crowding out existing commercial payors, the number of uninsured could drop considerably, while providing stability in insurance markets in regions that currently have limited access. Alternatively, if a public option had structural price advantages over commercial payors, private health insurance might be dropped by employers and relegated to a small segment of the market.

Probably the best outcome in terms of hospital credit quality is if the ACA were left intact, particularly if states that have not expanded Medicaid under the ACA reversed position. We observed a notable reduction in bad debt and an uptick in cash flow margins, which ultimately bolstered balance sheet strength, during the initial Medicaid expansion when the ACA became law. This supported an uplift in overall NFP hospital ratings in those states that expanded Medicaid.

Concurrent with these policy debates are on-going challenges to the ACA. Elimination of the ACA, through either the courts or administrative mandates, would be a clear credit negative for NFP hospitals. Millions of people would lose insurance coverage through a significant cutback in Medicaid eligibility and elimination of subsidized health marketplaces. Uninsured individuals would continue to seek care, resulting in an increase in hospital bad debt and charity care, leading to a reduction in hospital profitability.

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Special Assessment Debt: S&P Criteria Implementation Summary

Table of Contents

Key Takeaways

- We've reviewed all credits under our revised special assessment criteria since its publication in April 2018.
- Overall, the direction of rating actions to date has met our expectations, though the magnitude of positive rating actions has slightly exceeded our expectations.
- In particular, the frequency of upgrades for credits in California was more than double that of other states.
- Rated issuers consist almost entirely of fully or highly developed districts with minimal developer exposure, supporting credit quality.
- Although property value appreciation has begun to slow in most major real estate markets and distress metrics have increased slightly, real estate demand remains robust, and we believe that assessment areas with mature development will maintain strong credit characteristics.

Continue reading.

S&P USPF 2020 Outlooks.

All sector outlooks are stable with the exception of Higher Education which continues with a negative outlook for the third year. The record economic expansion has translated to overall credit stability in U.S. Public Finance and we expect this to continue in 2020. Despite favorable economic and fiscal trends we do see a precarious balance for 2020 as key credit risks such as retirement liabilities, event risk disruptions, global aging, and pressing infrastructure needs present budget and policy challenges in 2020 and beyond. We will continue to highlight Environmental, Social and Governance issues, which could lead to both positive and negative credit influences.

[Download Report.]

[Climate Risk Disclosure is Both a Challenge and Opportunity for Issuers.]

Climate change risks are becoming clearer for municipal issuers and market participants are counting on more disclosure about how those risks affect credit and global investor perceptions of the market.

The very way issuers disclose — or don't disclose — those risks to the broader public finance industry is under scrutiny, market participants have recently said, including panelists at The Bond Buyer's National Outlook Conference this week.

Nearly every panel touched on climate. Industry participants — from investors to data providers to ratings agencies to the issuers themselves — are beginning to speak more aggressively about the need for improved disclosure and increased spending.

Fifty-two percent of attendees who responded to a live survey thought that spending on climate change and cybersecurity will increase by 5% above overall budget spending and 68% of respondents said that issuers will incorporate environmental, social and governance (ESG) practices into their disclosure practices this year.

"We would like a little more detail than what is currently out there," Kurt Forsgren, managing director and head of sustainable finance at S&P Global (SPGI), said on a climate panel. While rating agencies, investors and bond insurers do their own due diligence on potential credit risks due to climate, essentially "we are still dependent on issuers for information," he said.

Forsgren said that sometimes current disclosures in official statements can seem a bit "couched" and there is an opportunity to give climate risks relevance and importance in ways that investors can understand.

Build America Mutual Chief Credit Officer Suzanne Finnegan, also speaking on the panel, said BAM considers climate factors when deciding whether it will insure a deal, and takes a "conservative" approach to viewing the potential risks versus the revenue pledges on those deals.

The risks municipal issuers face from climate change are not simply environmental — there are potential increased costs of paying for the infrastructure needs to preemptively deal with climate events and clean up after them. There is a need to assure investors through disclosures that governments are prepared to repay them if the costs become larger than expected. These factors are being discussed across trading floors, board rooms and through letters to investors from the world's largest asset managers.

"Will cities, for example, be able to afford their infrastructure needs as climate risk reshapes the market for municipal bonds?" Larry Fink, CEO of BlackRock (BLK), wrote in a letter earlier this month.

The issue could be looked at as a potential carrot and stick relationship for issuers.

William Glasgall, senior vice president and director of state and local initiatives at the Volcker Alliance, said that disclosure of climate risks is "inconsistent and incomplete." During a panel discussion, Glasgall said that while the Securities and Exchange Commission cannot tell issuers what they have to disclose, there is a potential that it could focus on climate risk and potential defrauding investors similar to how it focused on pension risks that were not disclosed in the past. "If the SEC decides that environmental, climate change is material, we could see enforcement and then we will see disclosure."

Some issuers are moving in that direction, whether by seeking third-party sustainability designations, focusing on ESG, green and marketing their bonds to investors that have mandates to invest in those types of bonds.

James McIntyre, director of capital markets at NYS Homes and Community Renewal, New York's state affordable housing agency, said that when issuers are planning their deals, "climate cannot sit over here and well, credit sits over there. All the projects we are doing — we are building resiliency into them."

McIntyre, speaking on an outlook and opportunities panel, noted that he and other issuers, such as the San Francisco Public Utilities Commission, are exploring ways to show their projects are sustainable, most recently by using the Sustainable Bond Network, a global online platform designed to improve transparency in the market for green, social and sustainability bonds.

And with the taxable bond boom that has drawn international investors, issuers can lure new investors.

"Issuers have a strong opportunity in 2020 to tell the story of the municipal market to a much broader investor pool through disclosures on climate risk, ESG factors and green bonds," said Will MacPherson, managing director at IHS Markit (INFO). "An international audience is growing for such disclosures and given the trend in taxable supply and interest in long-dated investments, tools are available to seamlessly expand the conversation into these new pockets of interest. The data is there; it simply needs to be articulated."

MacPherson said that while the additional disclosure requirements may be viewed as a burden by some, through steady repetition they could become a new standard over time.

"Having more eyes on munis is better for the market as a whole," he added.

McIntyre also said that international investors in particular are looking to munis as investments in their portfolios, pointing to Dutch and Canadian pension funds as examples, but they have certain mandates to invest in sustainable projects. He said there needs to be an educational effort with international investors and that issuers should "leverage our leverage" in that area.

Daniel Tomson, co-head of public finance at Citi, noted that because of the influx of taxable debt, Citi is deploying its bankers to educate international investors because demand there is a large part of why taxable munis have been well absorbed. Tomson said 2020 could be a bellwether year for the market.

Bob Spangler, co-head of municipal finance at RBC Capital Markets, said that large issuers such as California and New York are focusing more on ESG in their deals and that investors interested in ESG will begin to change issuer behavior, but he cautioned "it's going to be very slow."

As the current administration rolls back Obama-era environmental protections, it will leave it to the cities and states to take the lead on addressing climate risks.

What's needed is "a robust federal partner" in dealing with climate change and "right now, that's not what we have," said Dan Zarrilli, chief climate policy advisor and OneNYC director in the New

York City mayor's office. Zarrilli said that given that reality, the risks New York City faces in particular require the help of the financial markets and his office has plans to "fundamentally reshape this city over the new few decades."

Zarrilli said that climate change is an "all society" problem which all participants need to take seriously.

"Investors are increasingly … recognizing that climate risk is investment risk," Fink wrote. "Indeed, climate change is almost invariably the top issue that clients around the world raise with BlackRock."

By Lynne Funk

BY SOURCEMEDIA | MUNICIPAL | 01/30/20 02:42 PM EST

GFOA Releases New Report on Cyber Security.

A Byte of Prevention: Best Practices in Cybersecurity

All local governments are potential targets for cybercrime, a risk that intensifies as victims increasingly pay ransoms to regain access to their hijacked technologies. It can be tempting to pay up because hacks are disruptive, damaging, and embarrassing – and expensive.

As stewards of (often sensitive) public data, finance officers must understand the significance of this threat, including the large costs governments face in recovering lost data, restoring public trust, and otherwise recovering from a breach.

This report identifies simple simple and inexpensive strategies that address people, process, and technology to protect their organizations from cyber threats without conducting a costly cybersecurity assessment. Many of the recommendations on the following pages address the weakest link in cybersecurity: the human factor.

Download Report

How the Fed, Negative Rates Impact the Municipal Bond Market.

Chris Brigati, head of municipal trading at Advisors Asset Management, discusses expectations for lower-for-longer-rate policy for the Federal Reserve, the impact of negative interest rates on the municipal bond market, and market supply and demand. He speaks with Bloomberg's Taylor Riggs on "Bloomberg Markets."

Watch video.

Bloomberg MarketsTV Shows

January 29th, 2020, 9:36 AM PST

Goldman's Unusually Small Client: This $61,920-a-Year Prep School

- **Bank underwrites $8 million muni-bond deal for Milton Academy**
- **Boarding schools among issuers taking advantage of low rates**

Goldman Sachs Group Inc. is one of the biggest underwriters in the $3.8 trillion municipal-debt market because it chases big deals. But this week, it stepped back from that strategy to handle an unusually small sale for an elite Massachusetts boarding school.

The Milton Academy, whose alumni include billionaire Illinois Governor J.B. Pritzker, Robert and Ted Kennedy, and Nobel Prize-winning poet T.S. Eliot, sold $8 million in bonds this week to refinance older, higher interest-rate debt. The 1,000-student school, started in 1798, charges as much as $61,920 a year in tuition for high schoolers.

It's rare for Goldman to underwrite a deal that small. It hasn't managed a long-term municipal-bond offering under $10 million since at least 2013, according to data compiled by Bloomberg. Goldman held its slot as the sixth-biggest underwriter last year by managing just 86 deals. But because they were so large, that put it ahead of rivals like Wells Fargo & Co., Stifel Financial Corp. and Raymond James Financial Inc., all of which worked on far more transactions.

Elite boarding schools like the Taft School in Connecticut have been among those tapping the muni market to capture low interest rates, armed with huge endowments, strong credit ratings and high-society cachet. Milton Academy, which has a $329 million endowment, will also sell bonds for campus projects through a private placement next month, according to offering documents.

This week's bonds, which are rated AA by S&P Global Ratings, priced for yields as little as 0.03 percentage points above top-rated municipal debt.

While Milton Academy may not have the size of Goldman Sach's other muni-bond issuing clients, it has a roster of elite graduates and a curriculum that includes Latin, nuclear physics, ceramics and molecular genetics. The school has a five-to-one student-faculty ratio and allows its high school students to study abroad in China, France and Italy.

The school is in the midst of a $175 million fundraising campaign that's been supported by donors like hedge fund executive David Abrams and Boston Partners Chief Executive Officer Jay Feeney. Pritzker, who spoke at the school's graduation ceremony in 2019, also donated through his foundation.

Esten Perez, a spokeswoman for Milton Academy, declined to comment, as did Goldman spokeswoman Nicole Sharp.

Bloomberg Markets

By Amanda Albright and Danielle Moran

January 31, 2020, 6:15 AM PST

MacKay Municipal Managers Announces Top Five Municipal Market Insights

[For 2020.]

PRINCETON, N.J., Jan. 21, 2020 /PRNewswire/ — MacKay Municipal Managers™, the municipal bond team of fixed income and equity investment management firm MacKay Shields LLC, today published its top five insights for the municipal bond market in 2020.

John Loffredo and Robert DiMella, co-heads of MacKay Shields Municipal Managers, commented on the firm's outlook: "While we do not believe that 2019's municipal performance will repeat, we do expect that active management has the potential to enhance performance in 2020. We believe the most prudent strategy for 2020 is security selection based on the key qualities of prospective investments. Whether evaluating investment grade or high yield municipal bonds, we look beyond a stated rating to further assess each bond's structure, liquidity profile, rate sensitivity, and credit fundamentals. Anticipating the potential for periods of higher volatility, we also place a premium on maintaining liquidity as an essential strategy for capitalizing on the resulting opportunities that may arise."

MacKay Municipal Managers – Top Five Municipal Market Insights for 2020

1. **Security selection and bond structure drive performance.** Municipal credit spreads are tight, the yield curve is relatively flat, and absolute yields are low. We believe the tax-exempt municipal market will maintain its strong technical and fundamental characteristics versus other fixed income asset classes. However, successful municipal investing requires that investors plan how to generate strong relative returns, not hope for another year of outsized absolute returns. We believe that a relative-value based security selection strategy that incorporates rebalancing credit, reducing exposure to the long end of the market and favoring 4% and higher coupon structures will likely lead to outperformance.
2. **Tactically positioning portfolios when volatility rises can reward investors.** We believe that an ongoing low rate environment, monetary policy on hold and a mixed economic outlook point to coupon-dominant performance in 2020. However, the 2020 U.S. Presidential Election, foreign trade and the potential for weaker equity returns may create periods of notable volatility. Given the backdrop of strong technical conditions in the tax-exempt municipal market, prudent professional managers will seek to reward their investors by 'buying the dips.' However, it is essential to maintain adequate liquidity in preparation for seizing those opportunities coupled with an active trading strategy to monetize those positions.
3. **Strategic underweight exposures likely to drive outperformance in the high yield municipal market.** Quality high yield investments will be key as signs of distress appearing in certain pockets of the high yield municipal market suggest that poor security selection can lead to underperformance. Therefore, we believe a prudent focus on avoiding losers rather than stretching for winners will be the more successful strategy to investing in high yield municipal bonds by avoiding leveraged or speculative income.
4. **Taxable municipal refunding trend leaves the weak behind.** Although interest rate dependent, we expect that the 2019 surge in taxable municipal issuance to re-finance higher coupon tax-exempt debt will continue in 2020. A continuation of this issuance pattern would result in smaller, less sophisticated issuers being denied access to this re-financing activity, as the taxable market favors larger issuers of generally higher credit quality. We expect that taxable refunding activity will support supply-related technical conditions in the tax-exempt market, which will contribute to the overall market's relative performance strength. The combination of reduced supply pressure, ongoing strong demand for tax-exempt income and a shift in those credit sensitive sectors dictates even more need for sophisticated, credit research driven investment management and prudent security selection.
5. **Beware of fleeting income.** Coupon will likely be king this year but only when the quality of the

income source is high. We believe that assertion will hold true in both the investment grade and high yield segments of the municipal market. Investors should verify that their portfolio income is not reliant on strategies employing hidden leverage, excessive duration, speculative project bets or short call bonds on the verge of retirement. While market conditions in the last number of years were very forgiving with respect to such tactics, a turnaround would bring to light the fragility of those investment approaches.

To view the full outlook, please click here. For additional insights from MacKay Municipal Managers, please visit www.mackayshields.com.

OMB Releases Proposed Changes to the Uniform Guidance Covering Grants and Agreements.

The U.S. Office of Management and Budget has published for comment changes to sections of Title 2 of the Code of Federal Regulations (CFR) Subtitle A – OMB Guidance for Grants and Agreements, commonly referred to as the Uniform Guidance. The changes are in a number of areas but are geared toward aligning with the work already underway as part of the President's Management Agenda to standardize the grants management business processes and data, build shared IT infrastructure, manage risk, and achieve program goals and objectives.

NASACT is requesting comments on these important proposed changes no later than March 11.

There are a number of changes that could affect state government, however, below are a few areas of specific interest.

Government Quality Audit Project
J. Changes to Performing the Governmentwide Audit Quality Project – Proposed revisions to 2 CFR §200.513 include a change in the date for the requirement for a governmentwide audit data quality project that must be performed once every 6 years beginning with audits submitted in 2018. This date has been changed to 2021, given the significant changes to the 2019 Compliance Supplement in support of the Grants CAP Goal.

Aligning Federal Assistance with Federal Acquisitions
To further align implementation of FFATA, as amended by DATA Act, between the Federal financial assistance and acquisition communities, OMB proposes revisions to Federal awarding agency and pass-through entity reporting thresholds. For Federal awarding agencies, OMB proposes revisions to 2 CFR Part 170 to require agencies to report Federal awards that equal or exceed the micro-purchase threshold as set by the FAR at 48 CFR Subpart 2.1. Consistent with the FAR threshold for subcontract reporting, OMB is proposing to raise the reporting threshold for subawards that equal or exceed $30,000. OMB seeks comments that includes an analysis on the advantages and disadvantages of raising this threshold.

Addressing Pension Costs
E. Aligning 2 CFR with Authoritative Sources – OMB proposes a revision to 2 CFR Section 200.431 Compensation—fringe benefits to allow states to conform with Generally Accepted Accounting Principles (GAAP), specifically Governmental Accounting Standards Board (GASB) Statement 68, and to continue to claim pension costs that are both actual and funded. OMB proposes this revision because GASB issued Statement 68, Accounting and Financial Reporting for Pensions which amends

GASB Statement 27 and allows non-Federal entities (NFE) to claim only estimated pension costs in their financial statements. OMB's revision will allow non-Federal entities to continue to claim pension costs that are both actual and funded."

Using System for Award Management (SAM)/Unique Identifier
OMB's proposal to expand the applicability of Federal financial assistance in 2 CFR Part 25 beyond grants and cooperative agreements so that it includes other types of financial assistance that Federal agencies receive or administer such as loans and insurance will impact small entities, but it will not have a significant impact on a substantial number of small entities. Currently, 2 CFR Part 25 requires all non-Federal entities that apply for grants and cooperative agreements to register in the System for Award Management (SAM). OMB proposes to require all entities that apply for Federal financial assistance such as loans and insurance to register in SAM, which requires the establishment of a unique entity identifier. In practice, some Federal awarding agencies already require SAM registration for all types of Federal financial assistance and the proposed change would make this practice consistent among agencies.

There are many other areas to highlight including but not limited to:

- Domestic preferences for procurement. OMB is proposing to add 2 CFR 200.321 (Domestic preferences for procurement), encouraging Federal award recipients, to the extent permitted by law, to maximize use of goods, products, and materials produced in the United States when procuring goods and services under Federal awards. This Part will apply to procurements under a grant or cooperative agreement.
- A Proposal to standardize terms across 2 CFR part 200 to support efforts under the Grants CAP Goal to standardize the grants management business process and data.
- Proposing to clarify areas of misinterpretation such as the responsibilities of the pass-through entity to address only a subrecipient's audit findings related to their subaward.

RESOURCES TO ASSIST IN REVIEW

OMB is also providing a few resources to assist in review of the proposal, including a redlined version of the proposed changes.

Additionally, OMB will be hosting a listening session on the proposed revisions at 3:30 PM ET on February 4.

Comments on the proposal are due directly to OMB by March 23. To include your comments in NASACT's response, please send them to Cornelia Chebinou by Marcy 11.

For those filing direct comments to OMB, please visit Regulations.gov and search for the reference ID "OMB-2019-0005." OMB is also requesting commenters include the section of the guidance that their comment is referencing by beginning each comment with the section number.

Municipal Bond Perspective: Approach High Yield With Caution In 2020.

Summary

- The municipal bond market presents a number of unique features and characteristics that set it apart from traditional asset classes.
- Only around 10% of the municipal market would be considered below investment grade, based on

- the traditional breakdown of credit ratings (i.e., bonds rated BB and below).
- Historically, wider spread levels have provided opportunities for credit selection to drive incremental upside results, given the potential for spread compression amid improving fundamentals.

As we head into 2020, municipal bonds will likely remain attractive for many tax-sensitive investors, but their performance potential could prove to be relatively muted compared to 2019, according to Sheila Amoroso, director of our Municipal Bond Department. She and her team say this is due to the general level of interest rates and tighter yield spreads, particularly for lower-rated segments of the municipal market. They believe that while now may be a good time to consider a more cautious approach, they still see potential for high levels of tax-exempt income.

Continue reading.

Franklin Templeton Investments

By Sheila Amoroso, Senior Vice President, Director, Municipal Bond Department, Franklin Templeton Fixed Income Group; Daniel Workman, CFA, Vice President, Portfolio Manager, Franklin Templeton Fixed Income Group; Francisco Rivera, Vice President, Municipal Bond Department, Franklin Templeton Fixed Income.

Jan. 28, 2020

Muni Bond Investors Beware: 'Staged' Bond Defaults Are Back.

At first it seemed like we were starting off the new year on a happy note. Five bond defaults as of the first day of the year that were immediately remedied by a bond call at full value, plus 1%, payable on the last day of the month.

Having been around the horn, however, it seems more to me that “staged defaults” in municipal bonds are back. Such defaults are the bane of the municipal bond market since they are generally motivated by a desire to get out of a high coupon bond that has no early call provision. We saw a wave of such defaults in the 1980s as we came down from the high rates back then and I suppose, with the benefit of 20/20 hindsight, we can expect quite a few in 2020.

I was struck by the January 10, 2020 announcement by the Huntington National Bank that five of the bond issues it is trustee for, had not made their interest payments to the bank and therefore, the January 2 interest payment to bondholders would not be made. The bonds were thus declared in default. This was followed by a second letter from the trustee, dated the same day, advising that all the bonds from the five issues were being called by the obligor on January 31, 2020 at par plus a 1% premium plus accrued interest.

A call to the Huntington National Bank was not returned. I then turned to a recipient of the January 1 notice letter, Waldrep Law, which describes itself as “a boutique law firm specializing in business bankruptcy, healthcare restructuring and insolvency, and long-term care. We offer a unique combination of top-tier credentials and efficient, individualized client service.” As soon as I identified myself and why I was calling, I received a “no comment” and a hang-up. I then called Tortoise Credit Strategies LLC, a firm that represents itself as a “Bondholder Representative.” No call back from them either. I suspect they hold these bonds for investor clients.

Continue reading.

Forbes

by Richard Lehmann

Jan 27, 2020

[Avoiding Redemption Risk In This New Municipal Environment.]

Summary

- Growing threats to Municipal bondholders.
- Little known provisions can lay waste to bond values.
- Recommendations and strategies to escape getting burned.

Municipal bond issuers are under increasing pressure to fund their ballooning pension costs. Red flags are abundant in muni-land right now since many public entities are selling their assets – sewer and utility systems among them. Some are even merging with private entities to fund their growing liabilities. These types of transactions can have enormous negative repercussions and should put municipal bond investors on high alert. Specifically, investors should fear the triggering of Extraordinary Redemption Provisions (ERPs), explained below. I'll also recommend safe alternatives to buy, what to avoid, and what steps do-it-yourself investors can take to reduce risk in the muni market.

Significant events involving one of your municipal bond issues can trigger Extraordinary Redemption Provisions. This provision appears in the municipal bond's Official Statement. It states that if a certain event occurs, the issuer can redeem the bonds early. Sometimes this redemption can occur at par value $100, which can have huge downside ramifications for those who own bonds trading at a premium (above $100). ERP trigger events include unexpended proceeds, determinations that the status of the bonds are no longer tax free, changes in uses of proceeds, failure of issuer to appropriate funds, or destruction of facilities from which the bonds are payable. These events can cause massive losses if your bond has appreciated in market value and trades at a premium, such as $120. That premium can be lost in a heartbeat unless you have done the proper credit analysis.

Although this still happens only rarely, it has become more frequent of late. We are increasingly seeing privatization of municipal assets, as the issuers strain to fund their pension liabilities. We see this with water and sewer bonds. These were once considered the gold standard of the muni market. They were essential services, isolated from a municipality's pension liabilities. As some move from public to private they become far riskier.

Continue reading.

Seeking Alpha

Jan. 21, 2020

Alexander Anderson

S&P U.S. Not-For-Profit Health Care Rating Actions, December 2019.

S&P Global Ratings' U.S. Not-for-Profit Health Care rating actions in December were balanced with two upgrades and two downgrades. Outlook revisions were slightly more positive than negative in December with four favorable outlook revisions and three unfavorable outlook revisions. We consider a favorable outlook change to include revisions from stable to positive, negative to stable, or negative to positive, and vice versa for unfavorable outlook changes where the rating itself doesn't change. Overall, we affirmed 33 ratings, of which 12 were for new sales, in the month of December.

Our view of the sector remains stable. Continued balance-sheet strength combined with improving enterprise profiles as a result of mergers and acquisitions in addition to diversifying joint ventures drives our view of the sector, despite continual regulatory and financial risks. (U.S. Not-For-Profit Health Care 2020 Sector Outlook: A Precarious Balance As Evolution Continues, published on RatingsDirect Jan. 9, 2020.) Our 2018 median ratios also support our overall stable view of the sector and are highlighted by slightly improved operating margin performance overall following a two-year decline. Based on the 2018 ratios and our view of year-to-date results, we believe operating margins are generally stable, but at lower levels (U.S. Not-for-Profit Acute Health Care Ratios: 2018 Medians Show Operating Margin Improvement But Are Otherwise Stable, published on RatingsDirect Sept. 4, 2019).

Notable December rating actions include our downgrade on Tower Health to 'BBB+' from 'A' due to significantly weaker than expected financial performance and further expansion plans, which strain the balance sheet, and Winkler County Hospital District's downgrade to 'BB+' from 'AA' driven by the application of the acute-care criteria published March 19, 2018. This organization was previously rated under priority lien tax revenue debt criteria.

Continue reading.

S&P: Five U.S. State and Local Government Pension and OPEB Trends to Watch for in 2020 and Beyond.

Table of Contents

Key Takeaways

- As interest rates remain low, safer investment options may seem less attractive for U.S. pension funds needing to meet targeted returns.
- Pension reforms and efforts to improve funding discipline will continue, while weak funded plans are likely to consider new ways to solve funding challenges.
- Many state and local governments failed to make meaningful progress on their aggregate pension and OPEB liabilities last year.

- Changing demographics and workforce trends pose multiple risks to pension funding.
- As rising medical costs continue to outpace general price inflation, OPEB spending will likely grow as a significant cost pressure.

Continue reading.

S&P 'AAA' Rated U.S. Municipalities: Current List

Read the List.

S&P U.S. Higher Education Rating Actions, Fourth Quarter 2019.

The following tables summarize S&P Global Ratings' quarterly bond rating actions for its U.S. non-profit colleges and universities. All credit rating actions are based on our "Methodology: Not-Fo--Profit Public And Private Colleges And Universities" criteria, published Jan. 6, 2016.

View the tables.

Bonds are a Risky Way to Deal with Pension Woes.

By Jon Coupal, includes "Recently, this column exposed the foolishness of two proposed statewide bond measures: A $15 billion school bond, which will be on the March 3 ballot, as well as a 'climate resiliency' bond. … But at the local level, taxpayers need to be aware of a recent resurgence in the use of pension obligation bonds, a risky financing method that fell out of favor during the recession but is now making a comeback. …"

Read the full article on: The Daily Breeze (California)

Jon Coupal | January 27, 2020

Rainy Days Ahead: States Boost Reserves, Anticipating Slowdown.

An expanding economy led to expanded budgets. Now, with slowdown looming, rainy-day funds get more attention

As the longest economic expansion in American history continued last year, state governments increased salaries for teachers and other public employees, authorized new construction projects and — recognizing good times won't last forever — added to reserve funds.

Cash reserves could become more important this year, as experts project the economy to slow down in 2020. Though a full-scale recession seems less likely than it did at points last year, a slower rate of growth still appears likely. Fitch Ratings, a credit ratings agency, projects a 1.7 percent expansion in 2020, which would be the lowest level since 2011.

Understanding that growth — which has lasted since the Great Recession officially ended in June 2009 — can't last forever, most states have tried to budget conservatively and set money aside, according to Eric Kim, senior director of public finance at Fitch.

Continue reading.

Roll Call

by Jacob Fischler

Jan 27, 2020

Key Takeaways from Municipal Bankruptcies.

When strictly analyzing the default risk of your investment holdings, municipal debt is often regarded as one of the safest forms of investments – compared to corporate debt – because municipal bankruptcies are a rare occurrence in the United States.

This also means that municipal debt investors often spend more time analyzing other risk and intricacies of municipal debt like interest evaluating rate risk, comparing taxable and tax-free returns, and comparing revenue vs GO debt instruments. However, the number of recent municipal bankruptcies reminds investors to stay vigilant of the municipal default risk when making their fixed-income investment decisions.

In this article, we will take a closer look at the recent municipal bankruptcies, any commonalities, and what investors should look for before making their investment decisions.

Continue reading.

municipalbonds.com

Jayden Sangha

Jan 22, 2020

Urban Land Institute's Public/Private Partnerships Council Discusses 2020 Outlook.

Read the Report.

Urban Land Institute | Jan. 21

Muni Funds See Record Inflows in 2019.

Investors' appetite for municipal bonds soared last year, helping push already low muni yields even lower.

Municipal-bond funds saw record inflows in 2019, as investors poured a massive net $105.5 billion into muni open-end mutual funds and exchange-traded funds during the year. That amount dwarfed the annual gains of each of the past 25 years, including the group's previous boom year of 2009, which brought in roughly $75 billion.

Demand remained high throughout the year, as muni funds saw 12 straight months of net inflows over $5 billion, and by midyear had gathered 10 times the assets that flowed into those strategies in all of 2018.

Roughly 90% of 2019's flows went into actively managed mutual funds, yet a substantial $8.7 billion went to passive strategies, mainly muni ETFs, which have continued to gain prominence since they first arrived on the scene in 2000.

Continue reading.

Morningstar

by Elizabeth Foos

Jan 27, 2020

Muni Index Funds Are Moving Closer to Their Benchmarks.

- **'Tracking error' on funds has narrowed to 0.35%: Morningstar**
- **Muni-bond ETFs attracted a record $10 billion in 2019**

Municipal-bond exchange-traded funds, which attracted $10 billion in investor cash last year, are getting better at tracking their benchmarks.

The average gap between municipal-bond index fund returns and their targets fell to 0.35 percentage point for the three years ended Dec. 2019, compared with 0.57 percentage point for the 36-month period ended in November 2013, according to Morningstar Inc. Expanded electronic trading and improved sampling of bonds by large asset managers like The Vanguard Group Inc, BlackRock Inc. and State Street Corp. have lowered costs and made tracking more precise, said Neal Kosciulek, a Morningstar analyst.

"Managers themselves have gotten better and more experienced," Kosciulek said in a telephone interview. "A lot of that has to do with sampling, considering the size and diversity of the municipal-bond market. Picking the right bonds is very important."

A narrowing tracking error means investors are getting closer to what they paid for and could make muni ETFs and a small number of muni open-end index funds more appealing. At about $50 billion, muni ETFs comprise just more than 1% of the state and local government debt market, but the segment is growing quickly. Last year, muni ETF inflows grew 48% after increasing 26% the previous year, according to UBS Global Wealth Management's Chief Investment Office. Actively managed open-end municipal-bond funds include more than $800 billion in assets, according to Morningstar.

Index funds were slow to arrive to the fragmented and relatively illiquid $3.8 trillion muni market, which is comprised of almost a million securities issued by an estimated 50,000 municipalities. The first muni open-end index fund was created in 2000, according to Morningstar. The first municipal-bond ETF, iShares National Muni Bond ETF (MUB), was formed in September 2007, 14 years after the first ETF, the SPDR S&P 500 Trust was created by State Street.

"Liquidity and fragmented issuance were challenges that had to be overcome," said David Perlman, ETF strategist at UBS Global Wealth Management.

Sampling Process

Muni-bond indexes include thousands or tens of thousands of individual bond issues, and muni ETFS can't fully replicate them. Instead, portfolio managers use a sampling process, buying enough bonds from the index to match its key characteristics like sector, credit risk and duration.

Technology improvements have enabled fund managers to more effectively sample indexes by simplifying monitoring of changes to the funds' benchmarks and helping to identify bonds on the market, according to Kosciulek. And when a manager finds the bond, the expansion of electronic trading has made it less costly to buy and sell securities.

The average spread between what a seller receives and a buyer pays for a security with dealers acting as an intermediary dropped by more than half between 2005 and 2018, according to the Municipal Securities Rulemaking Board. Institutional investors who buy blocks of $1,000,000 or more are paying less than 20 basis points to trade on average, according to the MSRB.

More than 60% of institutional investors reported using electronic trading platforms in 2018, up from half only two years before, according to a survey last year by Greenwich Associates.

Both MUB and Vanguard's Tax-Exempt Bond ETF, (VTEB), the biggest muni ETFs, aim to mirror the S&P National AMT-Free Municipal Bond Index, which contains more than 12,000 bonds. MUB, which holds about 4,200 bonds, returned 7.28% last year on a net asset value basis, compared to 7.42% for the index. MUB's management fee is 7 basis points.

VTEB, with 4,350 bonds and a management fee of 8 basis points, returned 7.5% last year on a net asset value basis. VTEB had a slightly higher average coupon, stated maturity and duration than its benchmark.

Bloomberg Markets

By Martin Z Braun

January 21, 2020, 10:13 AM PST

A Massive Gap Explains Why Muni Prices Are Testing Record Highs.

- **Debt payments, mutual fund inflows outpace new debt sales**
- **'Everybody is just piling money into the muni market'**

Over the next month, about $25 billion of municipal debt will be paid off. Bondholders will receive another $13 billion of interest payments in February. And mutual funds have pulled in nearly $7 billion of new cash already this month.

Yet over the next four weeks, only a fraction of that money may find new securities to buy: American states and cities are so far set to sell just $13 billion of bonds in that time, according to data compiled by Bloomberg.

That yawning gap between the amount of cash looking to be reinvested and the amount of new securities being sold is driving the municipal market to new heights. Yields are at the lowest since the 1950s, 30-year munis are hovering around their highest values against Treasuries since at least 2001, and this month's 1.2% return marks the strongest start to a year since 2016.

"There is a mismatch between supply and demand," Matt Fabian, a partner at Municipal Market Analytics, said in a telephone interview on Wednesday. "Part of it is the continued trend of exceptional demand from last year."

Yields holding near lowest against Treasuries since at least 2001
The demand for tax-exempt debt has been fueled in part by President Donald Trump's 2017 tax law that capped state and local deductions, leaving investors in high-tax states looking for other ways to drive down what they owe. That's caused a steady influx of cash into municipal-bond mutual funds, which have gained money each week since last January.

At the same time, interest rates have fallen so low that governments can even sell taxable bonds to refinance their debts, contributing to a relative dearth of new tax-exempt securities.

So far, state and local governments have issued about $18.4 billion of new long-term bonds in January, the slowest start to a year since 2014, according to data compiled by Bloomberg. Some $5.7 billion were taxable.

"Everybody is just piling money into the muni market and there is only so much supply," said Jeffery Timlin, a managing director at Sage Advisory Services, an investment firm.

While the amount of debt in the pipeline will continue to increase, since many deals are scheduled with less than a month's notice, analysts don't see a pullback from the market on the horizon.

"We do not have reason to believe that the current trend of fund inflows will reverse any time soon," Wells Fargo Securities senior analysts Randy Gerardes and George Huang said in a report on Tuesday. "So, absent a significant build in the February calendar, we think the technicals will remain accommodative for a continued muni rally."

Bloomberg Markets

By Shruti Singh

January 22, 2020, 10:59 AM PST

— With assistance by Mallika Mitra

Muni Bonds That Deter Retail Investors Are Blowing Up (Podcast)

Retail investors are being steered clear of high-risk muni bonds by banks, who raise the minimum amount they can purchase. And more of those deals are getting into trouble. Reporter Amanda Albright and muni bond columnist Joe Mysak explore this booming segment of the municipal market, as well as mobile home parks in California.

Play Episode

Bloomberg

January 24, 2020 — 11:46 AM PST

How Investments in Innovation Districts Can Combat the Country's Regional Divides.

Last month, Robert D. Atkinson of the Information Technology & Innovation Foundation, together with our colleagues Mark Muro and Jacob Whiton, published a report calling for a renewed federal role in helping to balance the country's growing geographic inequities. "The case for growth centers: How to spread tech innovation across America" carefully documents how and why the innovation economy—the driver of much of the nation's growth—has become increasingly concentrated in a handful of coastal metropolitan areas, leaving much of the heartland struggling to keep pace. It also proposes a way for leaders in Washington, D.C. to boost lagging regions by selecting a small group of "growth center" metro areas (chosen via a competitive process) to receive a package of federal supports.

The "growth center" construct was originally conceived in the 1950s, but this 21st century version acknowledges that in today's economy, federal support for more widespread diffusion of innovative activity will not be enough to combat the entrenched economic divergence between regions. Rather, such "top-down" investment needs to be matched with "bottom-up" leadership, drive, and capacity to make the kinds of transformative investments in places and placemaking essential for growth centers to thrive.

Continue reading.

The Brookings Institution

by Jennifer S. Vey and Julie Wagner

Thursday, January 23, 2020

Claims By Tort Claimants Against Municipal Insurer Over Coverage for Sexual Abuse Dismissed By Federal Court.

Typically, a claimant has no direct right of action against an insurance company especially prior to a judgment against the insured. Even more typically, a claimant has no right to "cut-through" to the reinsurers based on an alter ego or fronting claim when the claimant is not the insured and is not in contractual privity. Nevertheless, that doesn't stop claimants from trying. In a recent case, a federal court rejected that attempt based on a lack of subject matter jurisdiction.

In *Bridges v. Poe*, No. 7:19-cv-00529-LSC, 2020 U.S. Dist. LEXIS 11240 (N.D. Ala. Jan. 23, 2020), a series of individual plaintiffs sued similar defendants for allegations of systemic sexual harassment, abuse and rape of female pretrial detainees at a city jail. After the first case was filed, the city's insurance company filed a state court declaratory judgment action seeking a declaration that it had no duty to defend or indemnify the city or its employees in the case. Subsequent cases filed by other plaintiffs in federal court named the insurance carrier as a defendant.

Each plaintiff alleged that the insurer was a shell corporation with no real employees, was merely the alter ego for a state municipality organization and a fronting company for the insurer's reinsurers. Plaintiffs, in the federal court actions, sought declarations that the insurance company had a duty to defend and indemnify the city defendants in the cases and that each plaintiff was an assignee of the insurance company's rights under its reinsurance contracts allowing plaintiffs to recover any judgment based on a cut-through to the reinsurers.

The insurance company moved in each of the federal cases to dismiss the claims against it for lack of subject matter jurisdiction. The plaintiffs argued that the court could retain the cases under supplemental jurisdiction. The district court granted the insurance company's motions to dismiss.

In granting the motion to dismiss, the court noted that the claims against the insurance company were state law claims between citizens of the same state. Thus, the analysis came down to whether supplemental jurisdiction was appropriate. Given that the claims against the insurance company were about insurance coverage, separate and distinct from the underlying tort claims, the court said that the exercise of supplemental jurisdiction "may not be appropriate." The court found that the claims against the insurance company alleging alter ego, fronting and as an assignee on a cut-through basis were not typical tort claims, were complex and hinged on whether the insurer was a shell corporation and a mere front for reinsurers. These allegations implicated matters of local law and policy. Because resolving these issues would cause the court to unnecessarily make decisions of state law, the court concluded that the state court would be better suited to hear and resolve those novel and complex state law claims.

The court also determined that it was not even clear that the plaintiffs had Article III standing to sue the insurance company for a declaration of coverage before the entry of judgment against the insured. Dismissing the claims, said the court, promoted judicial economy by avoiding substantial duplication of effort where there as a state case already pending.

January 24 2020

Squire Patton Boggs – Larry P. Schiffer

Chronically Late Municipal Bond Audits Further Delayed in FY 2018.

Every year since 2007, Merritt Research Services1 (Merritt Research) reports the time it takes for municipal bond borrowers to complete their annual financial audits. The results of the study consistently show slower reporting relative to industry standards of the securities markets. By now, it has been well documented that most municipal audits lag the corporate standard of 60 days by a range of three to six more months.

Slower audit turnaround times increase the likelihood that analysts will miss signals that may adversely affect municipal bond pricing and catch investors or other stakeholders off guard. In short, the useful value of the audits will become either stale or diminished, or potentially not useful at all. That concern is aggravated by the fact that the Merritt Research study evidenced that weaker borrowers generally experience longer delays than better quality credits to complete their audits.

This year's findings are particularly disappointing. Despite a decade of placing a spotlight on the problem2, audit reporting took another step down to tie the slowest median audit time recorded over the past eleven years.

Continue reading.

muninetguide.com

By Richard A. Ciccarone, President of Merritt Research Services, an Investortools, Inc. Company

Jan 13, 2020

U.S. Flood Risk Model to Be Publicly Available in Boon for Homebuyers.

NEW YORK — A climate research organization will offer access to a risk model that predicts the probability of flooding for homes across the United States, giving the public a look at the data institutional investors use to gauge risk.

First Street Foundation on Tuesday launched Flood Lab, a research partnership which provides eight universities with its model that maps previous instances of flooding as well as future risks. Using the dataset, Wharton business school at the University of Pennsylvania, Massachusetts Institute of Technology and Johns Hopkins University among others will quantify the impacts of flooding on the U.S. economy.

The move could put pressure on prices of homes, municipal bonds and mortgage-backed securities linked to real estate in risk-prone areas, according to Matthew Eby, executive director of research organization First Street Foundation, and other Flood Lab participants.

The data will be made available to the public in the first half of 2020 in an online database searchable by home address.

About 62 million American homes have a moderate to severe risk of flooding, data analytics firm Verisk has estimated.

Major risk modeling firms like Risk Management Solutions, CoreLogic, AIR Worldwide and KatRisk are currently the sole purveyors of that information, which they sell to big insurers, mortgage lenders and investment firms. But the cost, which can run into seven figures a year, is prohibitive for universities, smaller financial firms and homeowners.

"We tried to get some of the data from one of the providers and they quoted us an astronomical price," said Benjamin Keys, a real estate economics professor at Wharton.

Keys had reached an impasse in his research: he had evidence that mortgage markets in coastal regions of the United States were being affected by rising sea levels, but couldn't get accurate or comprehensive datasets that modeled the risk of flooding. Flood Lab will help fill that gap.

First Street says its model rivals those at big private firms. While there have long been researchers modeling flood risk, the timeframe and geographic scope have been limited as the manpower and cost have been too great for any one university. First Street currently has around 70 researchers working on its model, more than some of the proprietary firms.

Private risk modeling agencies will still have business: they offer other catastrophic risk data on a global scale and there is demand for multiple models. But a public option could lead to competitive pricing and a demand for transparency around methodologies.

The most lasting impact, however, is likely to be on homeowners.

“Where does your average homeowner get that flood risk information and make an optimal decision?” asked Carolyn Kousky, executive director of the Wharton Risk Center.

“I think that’s the place First Street will actually be disruptive.”

By Reuters

Jan. 14, 2020

(Reporting by Kate Duguid; Editing by Stephen Coates and David Gregorio)

‘That is Insane’: Muni Yields at the Lowest Since Elvis Was King.

- **The bond market’s oldest yield index hits lowest since 1956**
- **Steady influx of cash into market is keeping a rally going**

The last time municipal-bond yields were this low Dwight D. Eisenhower was the president, Elvis Presley released his second studio album and Grace Kelly married Monaco’s Prince Rainier III.

The Bond Buyer’s 20-year index of general-obligation bonds reset at 2.56% this week, the lowest since June 1956, according to Bloomberg’s records. And for some context, that year some $5.4 billion of new long-term bonds were sold, a sum that’s now considered a somewhat slow week.

The 20-bond index is the oldest gauge of yields in the tax-exempt securities market, started by the newspaper in 1917.

“That is insane,” said Nisha Patel, the director of portfolio management at Parametric, an affiliate of Eaton Vance Management. She said the massive amounts of money that have been flowing into mutual funds have driven down absolute yields, most notably for long-dated debt, as investors hunt for bigger payouts.

“One part of me thinks it’s hard to see how this is sustainable,” Patel said. “But another part says if Treasury yields grind lower, you could see this going down to 2%.”

Albert Jalso, a senior portfolio manager for Russell Investments, said the lower yields may increase the pace of new debt sales. “The state can say ‘hey, rates are lower, we can borrow a little more.’”

That’s the consensus view, with analysts forecasting a potentially record-setting year for new bond issues. Such sales have been met with seemingly boundless demand. Investors added another $2.3 billion to municipal-securities mutual funds in the week ended Wednesday, marking the 54th straight week of inflows, according to Refinitiv Lipper US Fund Flows data.

Patel said investors at some point may stop throwing their cash into the funds because of the "sticker shock" of how pricey — and low yielding — tax-exempt bonds have become.

"We started crossing over into taxables because of the richness," she said, saying that Treasuries look more attractive in this environment. "It's just extremely rich."

Bloomberg Markets

By Danielle Moran and Mallika Mitra

January 17, 2020, 10:31 AM PST

— With assistance by Joe Mysak

Negative Interest Rates x Negative Bond Yields = Positive Arbitrage?

Former Federal Reserve Chairman Ben Bernanke recently advised that the Fed should maintain "constructive ambiguity" about the possibility of taking the Federal funds rate below 0% in an effort to simulate the U.S. economy during the next recession. Given that current short-term interest rates in the United States are at near-historic lows, many believe that it is inevitable that U.S. monetary policy will replicate the negative interest rates employed in Japan and Europe when the next recession hits. One economist suggests that negative interest rates and negative bond yields (more on that below) are the inexorable conclusion of a trend that began in the late 1400s. We are on notice.

If the Fed experiments with a Bret Easton Ellis-inspired monetary policy and takes the Federal funds rate to less than zero,[1] what are the potential consequences for issuers of tax-exempt bonds? For some speculation (and to see the text of the first footnote), hit the jump.

Continue reading.

By Michael Cullers on January 20, 2020

The Public Finance Tax Blog

Squire Patton Boggs

Fitch Ratings Updates Infrastructure Completion Risk Criteria; Requests Market Comments

Link to Fitch Ratings' Report(s): Exposure Draft: Completion Risk Rating Criteria

Fitch Ratings-New York-15 January 2020: Project completion is a meaningful risk for project finance transactions, and has garnered significant attention recently with several infrastructure projects globally running into cost overruns and delays. As a result, Fitch Ratings has released an exposure draft for its rating criteria for completion risk, and is now requesting market commentary on the updated criteria.

“Delays, cost overruns and outright cancellations of high profile infrastructure projects in the U.S. and Canada are recent by-products of an increasingly competitive market environment,” said Global Infrastructure and Project Finance Head Cherian George. “In Latin America, completion risk has been manifested due to right-of-way, social and environmental issues,” said George. “Risk is getting pushed down to contractors in greater numbers, which is resulting in some fixed-price projects becoming unprofitable. The downfall of certain European contractors also highlights the pressure contractors are feeling.”

While the analytical approach is conceptually the same, Fitch will now break completion risk out into a separate standalone criteria that will shed more light on factors like a project’s complexity, scale, and duration (CS&D), availability of replacement contractors and contract terms. Fitch does not anticipate changes to its outstanding ratings as result of the new criteria.

Specifically, the exposure draft:
–Distinguishes the range of projects, using project CS&D as the attribute with the highest influence, although it is constrained by the weakest of all the attribute assessments.
–Explicitly recognizes the credit strength garnered from joint ventures (JVs) with joint and several liability, and distinguishes the relative strength of near-equal members, versus those with disparate expertise and credit strength.
–Recognizes independent engineer (IE) reports do not have global or regionally accepted or established standards for risk evaluation, so the opinions provided are not of consistent quality and reliability. The criteria therefore establishes a risk margin to replacement cost scenarios based on contractor credit quality. In addition in the absence of a well-substantiated IE opinion, the criteria establishes indicative security levels based on market input.
–Reflects the exposure to delay risk by establishing minimum thresholds, noting delay risk is relevant across all projects, regardless of counterparties.
–Clarifies notching between thresholds based on available performance security and liquidity.

Fitch invites feedback from market participants on the released criteria. Comments should be sent to criteria.feedback@fitchratings.com by March 15, 2020. Once finalized, Fitch will apply the criteria to existing ratings and apply the criteria described in this exposure draft to new projects during the exposure draft period.

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Additional information is available on www.fitchratings.com

Fitch Exposure Draft: Completion Risk Criteria FAQs

Read the FAQs.

S&P U.S. Municipal Housing 2020 Sector Outlook: The Foundation Remains Stable

Table of Contents

Outlook: Stable
Economic fundamentals bode well for continued stable performance in the U.S. public finance housing sector. Favorable financial conditions due to a lowered chance of recession, expected low rates through the end of the year, modest inflation, steady labor force participation, and continued wage growth–most importantly even for lower wage workers–provides a solid foundation for the sector to remain on largely stable ground during 2020.

Continue reading.

S&P U.S. Municipal Water And Sewer Utilities 2020 Sector Outlook: Finding Stability Between Headline Risk And Credit Risk

Table of Contents

Outlook: Stable
To the extent that utility leadership demonstrates proactive operational and financial risk management toward day-to-day challenges such as infrastructure renewals, as well as resilience to impactful events like extreme weather or a recession, credit quality can generally be preserved. Forward-looking analysis always begins with the capital plan.

Continue reading.

S&P U.S. Public Power And Electric Cooperative Utilities 2020 Sector Outlook: Heading Into A New Decade On A Familiar Road

Table of Contents

Outlook: Stable

Although U.S. public power and electric cooperative utilities face the specter of significant credit disruptors in 2020, we expect to see resilient and generally stable ratings. Electric utilities are benefiting from a predictable pathway for recovering costs, whether through autonomous or regulated ratemaking. Furthermore, the moderately growing economy and its low interest rates and natural gas prices is tempering pressures on income statements and balance sheets in this capital intensive industry.

Continue reading.

How Cybersecurity is Factoring Into Credit Ratings.

Cyberattacks are an emerging factor in public finance credit ratings for state and local governments, governmental authorities and non-profit community groups.

A couple of states already have stepped forward to help smaller communities and governmental authorities cope and about two dozen have formed state task forces.

A growing number of communities and government agencies also have taken out cybersecurity insurance policies.

"State and local governments are soft targets because they don't have the expertise in cybersecurity that corporations do," said Michael Belsky, executive director of the Center for Municipal Finance at the University of Chicago.

"I would say that being adequately prepared for a cyber event is a positive credit factor and being ill prepared is a negative credit factor," Belsky said in an interview.

Credit rating agencies are looking at the quality of the computer systems personnel and whether a government entity has a plan to deal with cybersecurity.

"It's more like a management practice like fund balance policy or revenue forecasting," Belsky said.

The first hard evidence of how this is affecting ratings in the public finance sector came from a downgrade two months ago involving Princeton Community Hospital in West Virginia.

S&P Global Ratings lowered its rating to BBB from BBB+ on series 2012A refunding bonds in November, more than two years after a cyberattack weakened the hospital's reserves which already were declining because of operating losses. Another factor in the downgrade was the integration risk associated from the acquisition of a regional medical center.

When the attack occurred in June 2017, the hospital had to divert ambulances and limit its services for seven weeks because the ransomware attack froze all systems including billing, accounting and electronic medical records.

Although S&P said the hospital's management "responded appropriately" to the cyberattack and the hospital did not violate its debt service covenants in fiscal 2018, the incident provides a good example of how a cyberattack can factor into bond ratings.

"We are saying now that an attack has affected operations of a public finance entity to be the primarily the attribute to lead directly to the downgrade," said Geoff Buswick, S&P Global Ratings managing director.

"We have watched this emerge over the past few years," said Buswick. "Now it's something that we are expecting every analyst to at least ask a question or two about on a call so it's more business as usual."

Moody's Investors Service hasn't downgraded any of its ratings because of cybersecurity risks as yet, but officials there said it could happen in the future.

"A lot of the losses have minimized because of cyber insurance or state support," said analyst Nisha Rajan, Moody's lead for ransomware attacks on local governments. "Smaller local governments tend to be more vulnerable because their budgets are smaller and there are less resources to tap."

A Moody's report last August highlighted the state support Louisiana provided when five school districts came under cyberattack.

Louisiana Gov. John Bel Edwards declared a state of emergency and the targeted school districts gained access to state resources from the Louisiana National Guard, Louisiana State Police, Louisiana Office of Technology Services and Louisiana State University.

The effort was coordinated by the governor's office of Homeland Security & Emergency Preparedness.

Similarly, the Moody's report noted that Colorado Gov. John Hickenlooper declared a state emergency in March 2018 following a ransomware infestation at the Colorado Department of Transportation.

Louisiana's response was aided by the fact that Gov. Edwards had established the Louisiana Cybersecurity Commission in 2017. About two dozen states have taken a similar step, including California, Texas, New York and Illinois.

Ohio received a credit positive from Moody's in November after Gov. Mike DeWine signed legislation creating a civilian cybersecurity reserve force, named the Ohio Cyber Reserve, to protect local governments, critical infrastructure and businesses from the impact of cyberattacks.

The 50 person unit is part of the Ohio National Guard.

Moody's said it "underscores the significant role states can play in helping governments respond to rising cybercrime."

The vulnerability is generally the greatest in smaller local governments and agencies.

"You have some state and local governments that are well-resourced that are able to mount a comparable defense to large private organizations," said Leroy Terrelonge, assistant vice president and cyber risk analyst at Moody's Investors Service.

"But you have in this large world of state and local governments you many that do not have the resources to have dedicated cyber expertise and to be able to protect themselves as well," Terrelonge said. "So when you have such a large attack surface for criminals that are looking to find weak links they can probe, it's a very rich target landscape."

At Fitch Ratings, cybersecurity risk is a factor in its ratings but not to the point where it has become a credit concern as yet, according to Managing Director Amy Laskey.

"We look at their general ability to deal with the unexpected as part of their ESG score," said Laskey.

Laskey the risk of cyberattacks is growing everywhere.

"There's going to have to be a lot more done to address it, as these events become more common and more sophisticated and potentially more impactful," Laskey said. "It's probably going to get worse and not better so the responses are going to have to get stronger."

The latest warning of the growing threat of cyberattacks came from the U..S. Department of Homeland Security and the Multi-State Information Sharing and Analysis Center shortfall after the U.S. killed Iranian Gen. Qassem Soleimani with a drone attack.

"The Iranians probably don't have military capabilities to fight person for person or weapon system for weapons system, but they have a very sophisticated cybersecurity wing," Buswick said.

On Jan. 7, Texas Gov. Greg Abbott and Texas Department of Information Resources executive director Amanda Crawford reported as many as 10,000 "probes" per minute of state agencies' computer systems that originated from Iran.

"That whole chain of events was pretty stunning and telling to what we have been warning," said Buswick. "Don't have your head in the sand on this. Prudent cyber hygiene is going to benefit everyone."

By Brian Tumulty

BY SOURCEMEDIA | MUNICIPAL | 01/14/20 02:35 PM EST

BlackRock's Larry Fink Sees Bond Peril for Cities Over Climate Change.

- **'This is going to change the municipal-bond market,' he says**
- **Puerto Rico, Houston, California a reminder of potential risks**

The head of the world's largest asset manager has a message for American cities that don't prepare for climate change: The bond market may not always be so welcoming.

BlackRock Inc. Chairman and Chief Executive Officer Larry Fink said in his annual letter to corporate executives that the risks posed by rising world temperatures will affect "both our physical world and the global system that finances economic growth." He said that includes the $3.8 trillion municipal-bond market, which finances the roads, utility systems and other infrastructure vulnerable to the impacts of devastating storms, wildfires or rising seas.

“This is going to change the municipal-bond market,” Fink said in an interview with television network CNBC Tuesday after the release of his letter. “Areas that are more impacted by climate change [are] going to have harder time to finance their debt if they don’t focus on the impact of climate change.”

Those risks have been drawing increased scrutiny in the state and local government securities market, underscored in recent years by wildfires that scorched California, the severe flooding of Houston and the heavy damage visited on bankrupt Puerto Rico by Hurricane Maria in 2017.

Yet such events have had little if any impact on the price of bonds sold by cities, counties and states, even though many are increasingly highlighting their vulnerability to climate change in prospectuses circulated to investors. That’s in part because natural disasters have typically brought an influx of federal aid, which isn’t guaranteed if such events become more common in the decades ahead.

In April, BlackRock [estimated] that within a decade more than 15% of debt in the S&P National Municipal Bond Index will come from regions that could suffer losses from climate change.

In his letter, Fink said BlackRock joined with France, Germany and global foundations to establish the Climate Finance Partnership, an effort to improve financing mechanisms for infrastructure investment.

“The need is particularly urgent for cities, because the many components of municipal infrastructure — from roads to sewers to transit — have been built for tolerances and weather conditions that do not align with the new climate reality,” he wrote. He added: every “government, company, and shareholder must confront climate change.”

Bloomberg Finance

By Danielle Moran

January 14, 2020, 9:00 AM PST

Larry Fink Defends BlackRock’s New Emphasis on Climate Change. What Investors Need to Know.

Larry Fink’s recent letters to CEOs and investors were certain to press buttons, because they dealt with BlackRock’s plans to address climate change.

Yet the reactions, Fink tells Barron’s, have been positive even as climate change has become a political football. “I received one of the great letters of my career from a client in a red state,” says the CEO of BlackRock (ticker: BLK). “This client was very thankful. This client said, ‘We have a 10- to 20-year investment horizon. We now need to look at how we think about investing.’ ”

BlackRock puts climate-risk analysis at the heart of its investing process and gives a huge boost to sustainable investing. The world’s largest asset manager aims to double to 150 the number of ESG exchange-traded funds that it offers around the world. BlackRock will also push companies to report on sustainability metrics and vote against managements that do not make sustainability disclosures.

“In the next five years, ESG will be one of the key lenses for how investors look at everything, from corporate to country to municipal,” Fink says. BlackRock also plans to withdraw from big thermal-coal producers in its active funds.

Jeremy Grantham, the investor and founder of GMO who has spent millions of dollars to raise climate awareness, calls BlackRock’s moves admirable. But why doesn’t BlackRock get out of thermal-coal producers in the index funds it manages, as well? Or, for that matter, from all fossil-fuel companies? After all, Grantham says, “oil is the mother and father of all vested interests.”

“It’s not my money,” Fink responds. “We can offer an index fund minus these, but if a client is giving me a contracted statement, then I have to be in [the specified] index…. BlackRock, as a fiduciary, isn’t permitted to say we need to be out of hydrocarbons because I believe in it. It has to put it through the lens of investment risk.”

Fink said that BlackRock would contact passive clients to tell them about the new offerings. Still, dumping hydrocarbons altogether means missing opportunities. “There’s a 50-year transition for energy, but some energy companies are moving faster than others,” he says. Once companies start making sustainability disclosures systematically, it will be easier to compare companies in actively managed funds and find the best ones, he says.

Fink describes himself as “an environmentalist: I personally don’t own hydrocarbons.” He admits he isn’t personally invested in his company’s own ESG ETFs, although he vows to do so this year in his BlackRock 401(k). He is also invested in BlackRock’s illiquid renewable-power funds.

Industry reactions to BlackRock’s moves were guarded. “Can you have it both ways?” asks Leslie Samuelrich, president of Green Century Capital Management, which offers a line of fossil-fuel-free funds. “We’ll have to see how committed BlackRock really is to addressing climate change—it’s still the largest investor in fossil fuels.” Samuelrich is also a member of the board of US SIF, a trade group for sustainable investing.

As for BlackRock’s withdrawal from big coal producers in its actively managed portfolios, Asha Mehta, a portfolio manager and director of responsible investing at Acadian Asset Management, says, “It’s not a big step in divestment, but it’s consistent with where the industry is going.” Coal shares have already tumbled, while oil has underperformed the benchmarks over the past 10 years.

Fink says, “Some would argue we were late. I don’t think so. Our job as a fiduciary is to be thoughtful and helpful to our clients.”

BlackRock’s moves put pressure on other big index investors like Vanguard that also have large active-management arms. “Vanguard funds are managed to specific objectives,” a spokesman says. “Vanguard has no plans to materially change these broad mandates, nor stipulate certain investing restrictions at the company or sector level.”

Despite the looming risks of climate change, Fink is optimistic about stocks. In 2020, “I think the market will be stronger,” he says. “I don’t see interest rates spiking up. We won’t see anything close to [last year], but could we see 8% to 10% for the market? Sure.”

“More people have underperformed because they derisked,” he adds. “The most important thing you can do for yourself is stay invested and be heavily invested in equities.”

Barron’s

By Leslie P. Norton

Jan. 17, 2020 4:41 pm ET

BlackRock Puts Sustainability at the Center of Investment Strategy, Expects More Transparency in Sustainability Disclosure.

Was it the heartbreaking photos of scorched koalas in Australia? Was it the pressure from activists such as As You Sow, which submitted a shareholder proposal asking for a report on how the company plans to implement the new Business Roundtable statement of purpose? (See this PubCo post.) Was it the press reports, like this one in the *NYT*, highlighting what appeared to be stark inconsistencies between the company's advocacy positions and its proxy voting record? Was it the protests outside of the company's offices by climate activists? The letters from Senators? The charges of greenwashing? Whatever the precipitating factor, in this year's annual letter to CEOs, Laurence Fink, CEO of BlackRock, the world's largest asset manager, announced a number of initiatives designed to put "sustainability at the center of [BlackRock's] investment approach." What's more, he made clear that companies need to step up their games when it comes to sustainability disclosure.

Ostensibly, none of the factors above triggered the change. In this NPR interview, Fink protested that they were "doing this on behalf of clients. I have not done this with the idea of focusing on any activist groups or any other voice. We are a voice to the investors. Our job is to be speaking on behalf of our investors. And I wrote this letter not as an environmentalist. I wrote this letter as a capitalist." What's more, he told NPR, there was no single event or conversation or news story that "flipped the switch" for him; rather, it was "really the sum of all my conversations in every part of the world with our clients and witnessing their questions about this. And it really became very clear to me—as somebody who'd been in finance for, you know, 44 years, it's very clear to me that we're at a point now where more and more people believe in the science of climate change. More and more people are worried about their portfolios and how their portfolio is going to be performing over a 10-year horizon."

According to Fink's letter, "[c]limate change has become a defining factor in companies' long-term prospects." Although he has seen many financial crises over the course of his long career, in the broad scheme of things, they have all ultimately been relatively short-term in nature. Not so with climate change: "Even if only a fraction of the projected impacts is realized, this is a much more structural, long-term crisis." As a result, "we are on the edge of a fundamental reshaping of finance":

> "Will cities, for example, be able to afford their infrastructure needs as climate risk reshapes the market for municipal bonds? What will happen to the 30-year mortgage—a key building block of finance—if lenders can't estimate the impact of climate risk over such a long timeline, and if there is no viable market for flood or fire insurance in impacted areas? What happens to inflation, and in turn interest rates, if the cost of food climbs from drought and flooding? How can we model economic growth if emerging markets see their productivity decline due to extreme heat and other climate impacts?"

The result, according to Fink, is "a profound reassessment of risk and asset values. And because capital markets pull future risk forward, we will see changes in capital allocation more quickly than we see changes to the climate itself. In the near future—and sooner than most anticipate—there will be a significant reallocation of capital."

Investors are now "recognizing that climate risk is investment risk," making climate change the topic that clients raise most often with BlackRock: what are the physical risks arising out of climate change? How will climate policy affect prices, costs and demand? How should investors modify their portfolios?

Sustainability at the center of investment strategy

Although the investment decisions are ultimately the clients', BlackRock's "investment conviction is that sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors. And with the impact of sustainability on investment returns increasing, we believe that sustainable investing is the strongest foundation for client portfolios going forward." What's important, he said on NPR, is making sure that more investors use sustainability as a metric to analyze their investments. BlackRock expects to create the tools, techniques and analytics to navigate the risks and opportunities related to climate change and other sustainability concerns.

To that end, BlackRock announced new initiatives, including "making sustainability integral to portfolio construction and risk management; exiting investments that present a high sustainability-related risk, such as thermal coal producers; launching new investment products that screen fossil fuels; and strengthening our commitment to sustainability and transparency in our investment stewardship activities."

With regard to divestment of coal investments, the NPR interviewer noted that BlackRock "will sell out of all companies that get more than a quarter of their sales from thermal coal. That still leaves some of the biggest coal producers in your portfolio because they do a lot of other things, too." Fink responded that "coal is a very small component of any investment universe." And of course, BlackRock is limited to exiting investments and integrating sustainability considerations into the investment process only in its active strategies and discretionary active portfolios, not its index funds. Of its $7 trillion in assets under management, reportedly about $4.6 trillion is in index funds and ETFs (although ETFs can vary).

A push for better sustainability disclosure

Importantly for companies, Fink maintained that everyone needs to see a "clearer picture of how companies are managing sustainability-related questions. This data should extend beyond climate to questions around how each company serves its full set of stakeholders, such as the diversity of its workforce, the sustainability of its supply chain, or how well it protects its customers' data. Each company's prospects for growth are inextricable from its ability to operate sustainably and serve its full set of stakeholders." If companies do not ultimately address sustainability risks, Fink wrote, they will find the markets to be a skeptical bunch; transparency, on the other hand, will attract investment.

Fink advocates adoption of the SASB standards for reporting on sustainability across a wide range of issues and the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) for evaluating and reporting climate risks. (See this PubCo post and this PubCo post.) While BlackRock is itself continuing to work on its own disclosures, as part of its engagement this year, it is asking companies to:

> "(1) publish a disclosure in line with industry-specific SASB guidelines by year-end, if you have not already done so, or disclose a similar set of data in a way that is relevant to

> your particular business; and (2) disclose climate-related risks in line with the TCFD's recommendations, if you have not already done so. This should include your plan for operating under a scenario where the Paris Agreement's goal of limiting global warming to less than two degrees is fully realized, as expressed by the TCFD guidelines."

BlackRock will use the information to assess companies' risk oversight and planning. Notably, in

> "the absence of robust disclosures, investors, including BlackRock, will increasingly conclude that companies are not adequately managing risk. We believe that when a company is not effectively addressing a material issue, its directors should be held accountable. Last year BlackRock voted against or withheld votes from 4,800 directors at 2,700 different companies. Where we feel companies and boards are not producing effective sustainability disclosures or implementing frameworks for managing these issues, we will hold board members accountable. **Given the groundwork we have already laid engaging on disclosure, and the growing investment risks surrounding sustainability, we will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."**

What's the impact?

So here's the question: how much impact, if any, will the Fink letter describing Blackrock's new strategy and initiatives have on the CEOs to whom it is addressed? With $7 trillion under management, BlackRock has a loud voice. And, to the extent that shareholders are actually driving this change, the message could be even more persuasive. It also seems likely that BlackRock's disclosure imperative and warning on holding boards and managements accountable for inadequate disclosure will sway many companies in which BlackRock invests. And disclosure is often considered to be an indirect way to compel change (sometimes known as "regulation through humiliation"). However, as Matt Levine observed in his Bloomberg column, how persuasive will the letter be to the CEO of the largely state-owned Saudi oil company, of which BlackRock is reportedly the largest outside shareholder?

What about more broadly—the big picture? Some might say that, historically, Fink's letters have had a major impact: consider, for example, his previous letters regarding the need for a defined corporate purpose (see this PubCo post and this PubCo post), seen by many as an influential precursor to the adoption by the Business Roundtable of a new Statement on the Purpose of a Corporation. That Statement outlined a "modern standard for corporate responsibility" that makes a commitment to all stakeholders and was signed by 181 well-known, high-powered CEOs. (See this PubCo post.)

Writing in the *NYT*, Andrew Ross Sorkin observed that, while previously "many companies and investors have committed to focusing on the environmental impact of business,… none of the largest investors in the country have been willing to make it a central component of their investment strategy." And BlackRock's "green push" takes on even greater significance as the current "administration is going in the opposite direction, repealing and weakening laws aimed at protecting the environment and promoting sustainability." As a consequence, Sorkin viewed BlackRock's change as a "watershed," a move that "could reshape how corporate America does business and put pressure on other large money managers to follow suit." So how much impact? Only time will tell.

Here is BlackRock's related letter to clients and FAQs.

January 15 2020

Cooley LLP

Municipal CUSIP Request Volume Increased 15% in 2019.

NEW YORK, NY, January 15, 2020 – CUSIP Global Services (CGS) today announced the release of its CUSIP Issuance Trends Report for December 2019. The report, which tracks the issuance of new security identifiers as an early indicator of debt and capital markets activity over the next quarter, found a significant year-over-year surge in request volume for new municipal identifiers. On a monthly basis, however, CUSIP request volume trended down in December across most major asset classes.

Read Report.

December Volumes for Municipal and Corporate Security Identifiers Trend Down.

"The overall volume of municipal and corporate identifier requests was strong in 2019, driven by a combination of a favorable interest rate environment and a generally strong economy," said Gerard Faulkner, Director of Operations for CUSIP Global Services. "As we turn the corner to 2020, our CUSIP issuance indicator appears to be signaling some caution on the part of market participants, but it is still early."

Read Press Release.

For Shrinking Cities, an Aggressive Way to Dodge the Census Bullet.

Places where the population is declining know it could cost them money after the 2020 head count is taken. The solution: Expand their borders to add more residents.

DECATUR, Ill. — The last three census counts brought bitter confirmation of what Decatur residents could already see for themselves, after the factories cut shifts and the neighbors moved away. Their city, whose welcome sign boasts of being the original home of the Chicago Bears, was shrinking.

But ahead of this year's official head count, Decatur officials are trying a new way to boost their numbers: If people won't move to Decatur — where downtown coffee shops are nestled amid mid-rise buildings, factories are hiring again and the area's first Chipotle just opened — Decatur will move to them.

Over the last year, the City Council pushed Decatur's boundaries outward, annexing hundreds of properties despite vehement objections from new residents whose spacious houses and half-acre lots contrast sharply with the smaller, aging homes in neighborhoods closer to downtown.

Continue reading.

The New York Times

By Mitch Smith

Jan. 17, 2020

A Tale of Two Community Reinvestment Act Proposals.

Even by banker standards, Martie North is a numbers person. She's a senior vice president at Simmons Bank, where she keeps close tabs on the bank's lending to low-income communities and community development projects across the bank's 35 markets.

As a regional bank based in Pine Bluff, Arkansas, with $17.8 billion in assets and around 200 branches across eight states, every market is a little bit different, and some markets are new to Simmons Bank — it's acquired 11 other banks since 2013, quadrupling in size. It just acquired another bank last year, in St. Louis.

Each market has annual targets for loans to low-income communities and community development. North sets the targets, and the bank's executive team and board approve them. She checks in with each market lead at least once a month.

Continue reading.

NEXT CITY

by OSCAR PERRY ABELLO

JANUARY 16, 2020

S&P U.S. States 2020 Sector Outlook: Finding Balance In Today's Lower-Fo--Longer Economy

Table of Contents

- Ratings Distribution
- What We Are Watching For In 2020
- Environmental, Social, And Governance Factors Coming More To The Forefront

Outlook: Stable
Although we highlight more potential credit disruptors than favorable opportunities, the overall expectation for 2020 is for U.S. state rating stability. There will continue to be a delicate balance between delivering the services constituents want and generating the necessary revenue. But, over time, maintaining structural budgetary operations may be a challenge with our economic growth forecast below 2%.

Continue reading.

S&P U.S. Local Government 2020 Sector Outlook: A Precarious Balance Of Stability And Uncertainty.

Outlook: Stable

Despite the possibility of a variety of potential disruptors, overall we expect stability to continue for local governments in 2020. With a long history of effective responses to unexpected circumstances as well as the recent trend of revenue growth, the sector is well poised to meet the challenges of the new decade. However, to maintain credit quality over the longer term, management teams will also need to be prepared when and if the credit cycle turns.

Continue reading.

S&P Charter Schools 2020 Sector Outlook: Clear Skies For Now, But Political Uncertainties Cloud The Horizon

Table of Contents

Outlook: Stable

Although we highlight more potential credit disruptors than favorable opportunities, the overall expectation for 2020 is for charter school rating stability. Despite the increasing political support for stricter charter laws in some states, federal government support for school choice remains strong, per-pupil funding is generally stable-to-growing, and student/parent demand for charter schools continues to grow.

Continue reading.

S&P U.S. Not-For-Profit Health Care 2020 Sector Outlook: A Precarious Balance As Evolution Continues

Table of Contents

Outlook: Stable

The 2020 outlook for the sector is stable, as it has been since 2015. While the sector's core strengths supporting stability–management acumen, excellent balance sheets, and improving business profiles–remain unchanged, their long-term sustainability rests in a precarious balance. Legal, regulatory, and policy developments pose uncertain, but potentially large risks, and nontraditional competitors could become meaningful business disruptors. The combination of more assertive nontraditional competitors, changing consumer expectations, and advancements in data analytics and other technologies are creating an environment that could result in meaningful change.

Continue reading.

Fitch Ratings Releases Final Revised USPF Tax-Supported Rating Criteria.

Link to Fitch Ratings' Report(s): U.S. Public Finance Tax-Supported Rating Criteria

Fitch Ratings-New York-10 January 2020: Fitch Ratings has released its revised "U.S. Public Finance Tax-Supported Rating Criteria," with modest changes to the exposure draft published on July 23, 2019. Fitch has concurrently released "Feedback Report – Comments on Exposure Draft: U.S. Public Finance Tax-Supported Rating Criteria", which summarizes feedback received during the exposure draft period and highlights changes made in the final criteria based on that feedback. The previous versions of tax-supported criteria have been retired.

"We embarked on this criteria revision after the First Circuit ruling upended the long-established belief in the municipal market that the payment of special revenue debt would continue during an automatic stay period," said Amy Laskey, Managing Director. "Fitch thinks the decision, having stood through two courts, substantially erodes the ability to confidently say that any legal protection can provide full insulation from the operating risk of the related municipality.

"As a result of this erosion of confidence, the criteria now limits the relationship between security ratings and the related government's Issuer Default Rating."

The revised criteria also clarify the relationship between the issuing entity and any related local government. This relationship limits the rating on revenue bonds with strong independent credit characteristics that are issued by enterprises of a local government with weaker general credit quality.
Fitch's fundamental methodology for rating local government debt has not changed, and Fitch expects approximately 20 ratings will be affected in sectors including utilities, school districts and other special districts.
As a result of the criteria change, affected ratings will be placed on either Rating Watch Negative, indicating a preliminary assessment that the distance between a security rating and the related general government credit quality is greater than is permissible, or Under Criteria Observation, indicating there is a potential credit impact, but the impact is more uncertain. Fitch will release a list of affected credits within the next week.

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Additional information is available on www.fitchratings.com

Fitch Feedback Report: Comments on Exposure Draft: U.S. Public Finance Tax-Supported Rating Criteria

Read the Feedback Report.

Fitch Ratings: Updated Report for Variable-Rate Demand Obligations and Commercial Paper

Link to Fitch Ratings' Report(s): U.S. Public Finance Variable-Rate Demand Obligations and Commercial Paper Issued with External Liquidity Support Rating Criteria

Fitch Ratings-New York-10 January 2020: Fitch Ratings has published the following updated report: "U.S. Public Finance Variable-Rate Demand Obligations and Commercial Paper Issued with External Liquidity Support Rating Criteria". This report updates the report published on Jan. 31, 2019 entitled "U.S. Public Finance Variable-Rate Demand Obligations and Commercial Paper Issued with External Liquidity Support Rating Criteria". The key elements of Fitch's external liquidity rating criteria remain consistent with those of its prior criteria report.

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Muni-Bond Shopping Spree Shows No Sign of Stopping.

High-income households looking for tax relief drove record inflows into municipal-bond funds in 2019

Investors are heading into this year still eager for municipal bonds after a 2019 buying binge supercharged returns.

High-income households looking for tax relief drove record inflows into muni-bond mutual funds last year, with the S&P Municipal Bond Index up 7.26% during the 12 months ended Dec. 31.

Some analysts project that muni-bond mutual funds will continue that growth in 2020.

"Basically all of that money has driven up prices," said Nicholos Venditti, a portfolio manager at Thornburg Investment Management.

Continue reading.

The Wall Street Journal

by Heather Gillers

Updated Jan. 10, 2020 10:36 am ET

Fitch Ratings 2020 Outlook: U.S. Public Finance (Outlook Compendium Report)

Read the report.

The Muni Bond Market's Biggest Credit Risk: Climate Change.

The risk isn't priced into bonds yet, but 2020 could change that.

The municipal bond market has staged a strong, somewhat unexpected rally in 2019, but faces growing risks from climate change, according to a growing number of investment firms.

"Extreme weather events pose growing risks for the creditworthiness of state and local issuers due to impact of those events on local GDP which could reduce GDP growth of affected metropolitan areas by 05% to 1%," BlackRock has warned.

Moody's climate intelligence unit, Four Twenty Seven Inc., in which it holds a majority stake, reports that rising temperatures, "if significant enough, now and over the ensuing decades … have the potential to lower revenue, increase expenses, impair assets and increase liabilities and debt."

The impact, of course, will depend on the strength of the economies affected and the costs of emergency responses and mitigation efforts, but the growing risks are something that all municipal bond investors, analysts and portfolio managers have to think about to a greater degree than previously, says David Alter, a portfolio manager and co-head of municipal bond research for Goldman Sachs Asset Management.

"The wildfires have drawn a lot of attention to the impact of climate change on muni bonds," says Alter. "In the case of California the power industry is now under pressure with its survival at risk."

California's biggest utility, PG&E, has filed for bankruptcy and undertaken mandatory rolling blackouts as a result of the growing number of wildfires. It now faces a "safety crisis" and may not survive in its current form, according to a recent Wall Street Journal story citing safety specialists, researchers, former regulators and other experts.

Despite these risks in California and in other states and municipalities affected by more devastating fires, floods or extreme heat, muni bond prices have not been affected significantly. “The marketplace has not discounted” these risks in places where it probably should, says Alter, adding that the rating agencies also are not doing enough analysis of the climate risks that municipalities face.

“Ratings agencies talk about climate risks, but I’m not seeing that reflected much in their ratings or views on securities packages,” he says.

2020 could be a turning point, however. It could be “the first time [that] climate change risks will be priced into some bonds … the most directly affected bonds,” says Matt Fabian, a partner at Municipal Market Analytics. “There is so much pervasive interest in climate change risk in the muni industry on the asset management side that it’s only a matter of time when it becomes apparent in prices.”

Most at risk are localities that are already economically challenged, located in low-tax states and threatened with extreme weather-related events. In contrast, “big city bonds are going to be protected by big states,” says Fabian. “There are literally no costs that New York State won’t pay to protect New York City … which is likely to be safer than small cities near the coast in New Jersey or Connecticut.”

He recommends that investors swap out of bonds issued by governments in areas most exposed to climate change risk, such as such as the coasts of Florida or the Carolinas, and into areas with less exposure, whether geographic or economic.

Extremely tight spreads in the muni market — 35 basis points between a 10-year A-rated revenue bond vs. AAA-rate general bond — make this an opportune time to make the switch, according to Fabian. Investors wouldn’t be giving up much yield to make the change, and tight spreads suggest the change to incorporating climate change risk will happen quickly in the market, rather than gradually, following a dramatic event.

Fabian recommends that investors also learn whether the managers of their funds are truly addressing climate change in their portfolios or just paying lip service to that analysis.

Alter says investors also need to focus on whether the management teams of municipal issuers are able to react quickly to climate events (which also suggests the importance of state governments) and whether local and state governments have the ability to protect local economies and bond markets.

He cites Florida’s legislative response to Hurricane Andrew, which devastated the city of Homestead in 1992. The state created two funds to address the impact on insurance market: a Hurricane Catastrophe Fund to reimburse insurers for a portion of their catastrophic hurricane losses and the Florida Residential Property and Casualty Joint Underwriting Association to provide certain residential property and casualty insurance coverage to qualified state residents.

That had a “huge impact on municipal market there,” says Alter, adding that California now has responsibility to fashion its own “big solutions.” California “passed a number of helpful bills but has not solved its power industry problems.”

The state imposed a one-year ban on insurers dropping customers in or alongside ZIP codes struck by recent wildfires, and it asked insurers to voluntarily stop dropping customers anywhere in

California because of fire risk for one year.

"Climate change is likely the biggest credit risk on our sector today, but we're coming from a place of extreme safety," says Fabian. The current default rate in the muni market is 0.3%.

ThinkAdvisor

By Bernice Napach | December 30, 2019 at 08:52 PM

Arizona State Retirement Bets Big on Private Credit.

Arizona State Retirement System is looking to dedicate $1 in every $6 it manages to direct lending — more than five times the industry average — in a move some see as a harbinger of what's to come for the booming asset class.

Investors have plowed hundreds of billions of dollars into private credit funds in recent years, lured by premiums that are more than 5 percentage points higher than competing public debt. Yet less than 3% of pension fund portfolios were dedicated to the sector as of December, according to London-based research firm Preqin. That may be about to change.

In a recent survey of firms managing nearly $400 billion in private credit strategies, nearly 90% said they expect pension funds to up their allocations over the next three years. The $15.8 billion Ohio Police & Fire Pension Fund, Columbus, said this month that it was cutting its high-yield exposure as it moves toward a 5% target for private debt. And in its most recent financial statement, the $52.3 billion Illinois Teachers' Retirement System, Springfield, said it "continues increasing exposures to private debt opportunities," even as it retreats from fixed income broadly.

"We've been invested in private debt since early 2013," said Al Alaimo, who oversees the $41 billion Arizona fund's credit investments and aims to boost direct lending, one of the most popular private credit strategies, to 17% of the portfolio from about 13.6% previously. "We were very conscious that we were an early adopter and we tried to lock up as much capacity as we could with managers we perceived as being the best."

Now others funds are catching on too.

The number of U.S. public pension funds active in private credit climbed to 281 this year, with a median allocation of 2.9%, up from 186 and 2.1% in 2015, according to Preqin.

That may not seem like much, but with $4.57 trillion in assets, even incremental increases in exposure can mean billions of dollars in inflows for alternative credit managers.

The Arizona State Retirement System, Phoenix, invests with some of the biggest players in the business, including Ares Management, HPS Investment Partners, Cerberus Capital Management, GSO Capital Partners, Oaktree Capital Management and Monroe Capital, according to fund documents.

Global pension funds are "increasingly attracted to the high current risk-adjusted returns offered through experienced private credit managers," said Ares CEO Michael Arougheti.

With a growing scarcity of higher paying assets to help pension fund managers meet their long-term obligations, the shift toward private debt appears poised to accelerate.

Yields on more than $11 trillion of debt globally are still in negative territory. Blue-chip U.S. company bonds pay roughly 2.9%, near multiyear lows, while speculative grade notes yield about 5.1%, the least since 2014.

Direct lending, in contrast, offers an average yield pickup of 5.14 and 5.3 percentage points vs. the average rate on speculative grade bonds and leveraged loans, according to a Goldman Sachs Group analysis based on data through June 30.

That's helped assets in private credit strategies balloon to more than $800 billion.

Yet all that money pouring in is making the asset class more competitive, and thus less attractive, according to Neil Sheth, director of global research for NEPC. The influx of cash may fuel weakening lending standards, and the investment consultant, which counts public pension funds such as the Arizona fund as clients, is urging investors to be diligent committing significant capital to such an illiquid asset class amid a maturing credit cycle.

"If you're just learning about and thinking of putting a lot of capital in the space right now, you're too late," Mr. Sheth said.

The Arizona retirement system — which oversees the benefits of nearly a quarter million people — is already exploring alternatives strategies such as litigation finance and securities backed by aircraft leases to help boost returns going forward.

These more opaque corners of the market are part of its push to bring its investments in illiquid credit to nearly a quarter of its portfolio over a three-year period, according to Mr. Alaimo.

"We wish there were fewer people in the marketplace," Mr. Alaimo said. "However, the reality is if you partner with the right managers, they can be discriminating in the deals that they do."

Pensions & Investments

December 30, 2019 09:53 AM

Muni-Bond Shopping Spree Shows No Sign of Stopping.

High-income households looking for tax relief drove record inflows into municipal-bond funds in 2019

Investors are heading into this year still eager for municipal bonds after a 2019 buying binge supercharged returns.

High-income households looking for tax relief drove record inflows into muni-bond mutual funds last year, with the S&P Municipal Bond Index up 7.26% during the 12 months ended Dec. 31.

Some analysts project that muni-bond mutual funds will continue that growth in 2020.

"Basically all of that money has driven up prices," said Nicholos Venditti, a portfolio manager at Thornburg Investment Management.

Continue reading.

The Wall Street Journal

By Heather Gillers

Updated Jan. 2, 2020 5:05 pm ET

Pension Cuts May Pose Special Risks For Public Workers Not Covered by Social Security.

About 5 million state and local workers are outside of the federal retirement program.

There are millions of state and local public employees across the U.S who are not covered by Social Security, and are banking instead on government pensions as a main source of retirement income.

Researchers with the Urban Institute recently highlighted how these workers could face unique vulnerabilities with their financial security in retirement, especially as some states and localities seek to rein in spending on pensions by making benefits less generous.

An analysis the researchers conducted found that employees who are not in the Social Security system and who were hired in 2018 generally saw rules governing their pension plans that were more stringent than those for workers hired in 2008. The result is that the more recently hired employees will see lower retirement benefits.

Continue reading.

Route Fifty

By Bill Lucia

Jan 2, 2020

Municipal Bond Market Eclipses the $400B Mark in 2019.

2019 was a strong year of performance for bonds, particularly fixed income ETFs, which saw notable interest during times of heavy volatility. The municipal bond market also made out well, hitting over the $400 billion mark.

"The municipal bond market eclipsed the $400 billion mark for the fourth time since 2010, thanks to taxable trend that led to a vault in fourth quarter volume," a Bond Buyer report noted. "Municipal issuance picked up the pace in December to the tune of $40.79 billion, with taxable bonds accounting for about a quarter of the month's supply. For the year, volume jumped 21.8% to $421.69 billion from $346.06 billion in 2018."

Not only has it been a strong December, but also a strong decade for municipal debt—marked by stability, which has made them a prime alternative when considering safe haven assets.

“Muni credit has become increasingly stable as the decade progressed,” wrote John Hallacy in Bond Buyer. “Going back to the days of recalibration of ratings, the rating spectrum outstanding has contracted along with spreads. There are many more Aa/AA category ratings than ever before. Analysts use fine gradations to differentiate credits but at times those efforts are lost on the market.”

“The credits that depart from the norms become very well known in a relatively short period of time,” Hallacy added. “Resolution of these cases can take considerable time, expense and effort. We should be further along to closure on some of the issues revolving around Puerto Rico. There is still ample time for testing legal concepts within the proceedings. All parties have a different perspective on what constitutes fair settlements. We can only hope that resolution comes well before the end of the next decade.”

ETF TRENDS

by BEN HERNANDEZ

JANUARY 3, 2020

U.S. Muni Bond Funds Post Record Inflows in 2019 - Lipper

Investors seeking to dodge risk and ease their tax burden poured a record $94.05 billion into U.S. municipal bond funds in 2019, according to preliminary data from Refinitiv Lipper on Thursday.

Last year’s fund flows beat the previous record set in 2009 when they totaled $81.06 billion, said Tom Roseen, who heads research services at Lipper, which has been collecting weekly net flow data since 1992.

Chris Mier, a managing director at Loop Capital Markets, said a lot of cash was exiting “risky” equity funds in 2019 for “less-risky” muni funds, which hold bonds sold by states, local governments, schools and other issuers.

The federal Tax Cuts and Jobs Act of 2017, which capped deductions of state and local taxes (SALT) at $10,000, has also increased the popularity of tax-exempt municipal debt.

“The (act) stoked demand for tax-advantaged investments given the increased tax burden faced by many taxpayers from the ‘SALT states,’ which imposed greater tax burdens,” Mier said.

In the most recent week, which ended Jan. 1, muni bond funds reported $280.6 million of net inflows, Lipper said. Flows have been positive since the week that ended Jan. 9.

Meanwhile, debt issuance in the U.S. municipal market totaled $406.5 billion in 2019, a 27% increase from 2018, according to Refinitiv data released on Thursday.

Lower interest rates spurred a 54% increase in bond refundings, which totaled just over $155 billion. The state of California was the year’s biggest debt issuer, selling nearly $9.49 billion of bonds, followed by the New York State Dormitory Authority with $8.84 billion of bonds.

Bank of America Securities was 2019’s top underwriter of municipal bonds, followed by Citigroup, Refinitiv reported.

Reuters

January 2, 2020

(Reporting by Karen Pierog in Chicago Editing by Matthew Lewis)

[Bond Funds Had a Strong 2019. Next Year's Performance Depends on This One Factor.]()

Investors will likely keep sending cash into bond funds in 2020, according to Ned Davis Research—and that could help fuel future market gains.

Bond markets posted strong performance in 2019. Investment-grade corporate bonds brought in 14%, Treasuries returned 7.6%, and high-yield bonds gained 12%, according to ICE BofAML Indices. Tax-exempt municipal bonds returned 7.4%.

Investors sent a steady flood of cash into bond funds in 2019. While they were likely responding to strong fixed-income performance, the influx of cash started a virtuous cycle that drove further bond-market gains. Taxable-bond funds brought in a net $518 billion of investor cash for the year ended Dec. 25, according to Refinitiv Lipper data, while municipal-bond funds attracted $65 billion of net inflows.

Continue reading.

Barron's

By Alexandra Scaggs

Dec. 31, 2019 10:31 am ET

Fitch Ratings: U.S. Port Ratings Largely Resistant Thus Far to Trade Policy Changes

Fitch Ratings-New York-20 December 2019: Prolonged trade tensions between the U.S. and China has created quite a bit of headline risk for U.S. ports, though Fitch Ratings' latest sector peer review shows that it has not trickled down to financial or rating performance.

Both ratings and Outlooks have largely remained intact for Fitch-rated ports, perhaps most surprisingly for those located on the West Coast. Despite volume declines, which were expected seeing as West Coast ports are the most susceptible to U.S./China trade disruptions, financial and rating performance has remained quite stable. 'Landlord ports are generally not directly exposed to volume volatility, which has insulated cash flow for ports like Long Beach and Los Angeles, CA despite their tariff-related declines in volume,' said Director Stacey Mawson.

The lone rating revision was to Alabama State Port Authority, which Fitch downgraded earlier this year, largely reflecting its exposure to coal. The 'A' category remains the most common rating level for stand-alone U.S. ports. Additionally, prospects for rating change over the next year are highly unlikely with all Fitch-rated ports now having a Stable Outlook.

Fitch has also released its 2019 update to the interactive peer study for standalone U.S. port credits, the Fitch Analytical Comparative Tool, or FACT, concurrently with release of today's peer review.

FACT uses an interactive interface to easily review and compare key credit metrics that underpin Fitch's analysis of U.S. ports, allowing users to select subsets of Fitch's rated ports for comparison. The interactive FACT tool contains key financial information for Fitch-rated standalone port issuers in the U.S., graphical plotting function for annual and median performance and a radar chart that indicates key risk levels. The tool allows selection of medians by rating category as well as by market size.

For more information, please access the 'U.S. Ports – 2019 Fitch Analytical Comparative Tool (FACT)', as well as the complementary report 'Peer Review of U.S. Ports (Attribute Assessments, Metrics and Ratings)' at www.fitchratings.com or by clicking on the above links.

'United States Seaports – Peer Review' is available at 'www.fitchratings.com'.

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Muni-Bond Safeguards Weakened as Investors Scrounge for Yield.

- **Covenants are meant to guard investors from bond defaults**
- **Market moved 'toward lighter covenants' this year: Fabian**

With interest rates at near record lows and vast amounts of cash seeking a home, some issuers in the municipal-bond market have shed financial safeguards investors once could demand before buying.

The weakening of those covenants, especially on high-yield and lower investment-grade deals, has raised the specter of more defaults in the $3.8 trillion state and local debt market, a haven where failures are still relatively rare. And amid seemingly insatiable demand in a sellers' market, muni buyers likely will continue to accept fewer protections against default or bankruptcy.

"The only movement this year has been toward lighter covenants," says Matt Fabian, a partner at

Municipal Market Analytics. “Next year is geared for more of the same — slowly tighter spreads, steadily strong demand.”

Covanta Holding Corp., a waste management company, offered no debt service reserve fund or mortgage pledge to investors when it sold $50 million in junk-rated bonds earlier this year. Nor did the Brooklyn Law School, which sold Baa1 rated debt in May. As part of that refunding, the law school terminated a mortgage that prior bondholders had on campus property. And the Pan-American Charter School, which sold unrated debt in July, didn’t offer a debt service reserve fund to investors when it sold bonds to build a new charter school in Phoenix.

Covenants “have definitely gotten lighter” in the last two years given strong demand for municipal debt, said Matthew Stephan, head of municipal bond credit research for Columbia Threadneedle Investments. Bond buyers have accepted “weaker” covenants except in very risky deals that draw narrow interest, he said.

A Covanta spokesman didn’t immediately respond to a call seeking comment. Officials from Brooklyn Law School and Pan-American Charter School weren’t able to immediately comment.

High-yield muni-debt funds have seen $18.5 billion in cash flood in during 2019, the highest since records began in 1992, according to Refinitiv Lipper US Fund Flows data. That’s helped propel high-yield municipals to a 10.6% return this year, the most since 2014, according to Bloomberg Barclays indexes. Municipal-bond mutual funds have enjoyed 50 straight weeks of inflows, including $1.56 billion of new cash during the week ended Wednesday, according to Refinitiv Lipper.

All that demand has helped pressure yields and made borrowing cheaper for issuers with lower credit ratings. Along with the coupon and yield bond investors also receive “pledged security” from borrowers but it appears that “if investors are willing to relent on income, they’re likely willing to relent on security as well,” Fabian said.

With the trend of looser covenants expected to continue, credit surveillance and open access and trust in management becomes more important, said Dora Lee, director of research at Belle Haven Investments, which manages about $10.6 billion of municipal bonds. Investors have to ask themselves whether they want to take additional risk as spreads tighten, Lee said.

“In theory, covenant breaches give bondholders time to intervene before there is a monetary default,” Lee said. “With covenants so weak, there is less time for bondholders to do that.”

Bloomberg Markets

By Shruti Singh

December 20, 2019, 10:30 AM PST

— With assistance by Amanda Albright

Cash-Hungry Cities Seek Buyers for Sewer Systems to Pay Pensions.

- **Illinois city joins peers in exploring sale of waste system**
- **Asset sales offer chance to pay down debt, but carry risk**

As cities across the U.S. struggle under the weight of ballooning pension costs, some are putting their public water and sewer systems on the auction block to come up with cash.

Municipalities took in more than a half a billion dollars over the past five years by selling their water and waste utilities to private companies, according to data compiled by Bloomberg. Such sales are increasing in places such as Illinois, where the state alone owes $137 billion to its pension funds and dozens of cities have saved far less than they need to cover all the benefits promised to police, firefighters and other public employees.

In the last decade or so, selling off municipal assets had become a tool of last-resort used by governments facing dire financial strain. Arizona famously sold its capitol in 2010 as it struggled to fill an historic $3 billion budget deficit. But water and sewer utilities offer municipalities a chance to come up with much-needed cash and relief from maintenance costs at a time when states and localities have a combined $4.2 trillion in unfunded pension liabilities.

“A lot of these municipalities are having other financial pressures,” said Ryan Wobbrock, a senior credit officer at Moody’s Investors Service. “Being able to sell the system can provide cash to meet those other obligations like the pension or put the system in the hands of a much larger entity that can leverage its economies of scale and make the necessary investments.”

Granite City, Illinois, a rust-belt town of 30,000 people on the Mississippi River, is facing a $130.8 million pension shortfall and has put part of its sewer system up for sale to raise funds. Illinois American Water — a subsidiary of American Water Works Co., the largest publicly traded water utility in the U.S. — has offered the only bid, though city officials won’t say yet for how much or how they would spend the cash.

Pension Bond

Granite City sold a $40 million pension obligation bond in 2017 to make a payment into its pension systems that have roughly 42% of the cash they need to pay future benefits, betting that borrowing costs for the bond would be lower than its pension investment returns, according to Moody’s. Still, the city has not made its required pension payments for the past two fiscal years, according to budget documents.

“It wasn’t paying into its pension system when it should have been paying for many years,” Amanda Kass, associate director of the Government Finance Research Center at the University of Illinois at Chicago. “For some places like Granite City, yes the problem has kind of snowballed and they may not be able to remedy it on their own.”

Alton, Illinois earlier this year sold its wastewater system to Illinois American and used the entire $53.8 million to chip away at its $134 million in pension liabilities. Godfrey, Illinois also sold a system this year that desperately needed upgrades to Illinois America. Mayor Mike McCormick says he’s stashing the money in a rainy day fund.

American Water and its rival Aqua America Inc. have spent about $655 million since 2014 buying 135 utilities in states including Pennsylvania, Illinois, Indiana, Virginia and West Virginia and Texas, according to filings with the Securities and Exchange Commission. Both companies say they are on the hunt for more. They are likely to find willing sellers as well, said Michael Bennon, managing director at the Stanford University Global Projects Center.

“There is certainly a bit of a trend in that a lot of the cities that are considering these transactions are burdened by pension liabilities or have other fiscal constraints,” said Bennon, who advised Connecticut when the state was exploring the possibility of an asset sale to shore up its pension system. “That’s not the right reason to consider one of these contracts, of course, but it is a common one.”

Carries Risk

In Pennsylvania, the city of Allentown and Middletown Borough sold long-term leases for their sewer and water systems to pay down pension debt in 2013 and 2014. Jacksonville, Florida, is exploring the sale of JEA — the largest community-owned water, wastewater and electric power utility the state. The city is seeking at least $3 billion in net proceeds from the profitable utility after paying off $3.6 billion in outstanding debt on its books, according to financial filings.

Jacksonville has cited a changing utilities industry as one of the reasons for a sale of an asset that was able to contribute $132.8 million to the city’s general fund last fiscal year. The city’s three pension funds are a collective 55.7% funded and have $3.2 billion in unfunded liabilities, according to its most recent financial report.

Still, using proceeds from an asset sale to shore up a pension system carries risk of its own, said Thomas Aaron, a senior analyst at Moody’s. An infusion of cash from a sale would immediately increase a plan’s assets, but those funds would be invested according to the style of the plan — meaning they are subject to market forces, Aaron said.

“If those proceeds are then invested in high-risk, high-return investments that carries risk,” Aaron said. “As you move out a few years into the future, if those assets under perform relative to expectations or in a worst-case, they suffer significant losses, there’s no longer an option to bring in additional funds to pay down the pension debt.”

Bloomberg Deals

By Fola Akinnibi

December 17, 2019, 7:50 AM PST

CDFA Legislation to Modernize Private Activity Bonds Introduced in Congress.

The Modernizing Agricultural and Manufacturing Bonds Act (MAMBA) is a common-sense, bipartisan, targeted reform package that will modernize two categories of qualified small issue private activity bonds: Small Issue Manufacturing Bonds (more commonly known as Industrial Development Bonds (IDBs)), and First-Time Farmer Bonds (also called Agricultural Bonds, or simply Aggie Bonds). These types of bonds are key economic development tools used by state and local agencies to finance the small- to mid-sized manufacturing and agricultural sectors.

Unfortunately, IDBs and Aggie Bonds have not been modernized in over 30 years, causing stagnation and decline in these respective industries. Over the past decade, IDB and Aggie Bond issuances have substantially declined due in major part to the outdated rules and regulations that govern the use of these bonds. The six reforms contained within MAMBA will update the Internal Revenue Code (IRC)’s private activity bond rules for IDBs and Aggie Bonds. The six reforms are as follows:

1. Expand the definition of “manufacturing facility”
2. Eliminate restrictions on “directly related and ancillary facilities”

3. Increase the maximum IDB size limitation from $10 million to $30 million
4. Increase the limitation on small issue bond proceeds for first-time farmers
5. Repeal the separate dollar limitation on the use of small issue bond proceeds for depreciable property
6. Modify the definition of "substantial farmland"

Read more.

The World Bank Releases 2019 Green Bond Impact Report.

Read the report.

The World Bank | Dec. 26

Big Cities Mostly Prepared to Weather Next Recession, Report Says.

Chicago and Detroit are outliers, least able to withstand a recession, among the big cities examined by Moody's, which looked at how prepared cities are when a downturn comes.

If a recession descends on the U.S., a recent report that looked at the finances of major urban centers found that 23 of the country's largest 25 cities are fiscally prepared.

The analysis by Moody's Investors Services, a business and financial services company, concluded that 17 of those cities are "moderately prepared" for a recession, while six—Boston, Charlotte, Denver, San Antonio, San Francisco and Seattle—are in strong positions. But both Chicago and Detroit are in weaker states if there is a financial downturn, the analysis found.

Moody's does not anticipate a recession in the immediate future, the report notes, though risk of a downturn "remains elevated." The findings are in line with a recent survey by the National League of Cities, which highlighted that finance officials from big cities are concerned about a recession coming as soon as next year, while remaining generally optimistic about their governments' ability to deal with the decreased revenues that would likely follow.

The analysis examined four factors to determine preparedness, including fiscal volatility, reserve coverage, financial flexibility and pension risk. The results reflect a city's ability to handle a recession of similar magnitude to the economic downturn in 2008 and 2009, and show that 23 of the country's 25 largest cities by population can emerge from a similar crisis without a "material adverse credit impact." That's largely due to cities' smart investments in the past decade, said Nicole Serrano, a vice president and senior analyst for Moody's.

"A majority of local governments have used the broad economic expansion of the past decade to strengthen their finances," she said in a statement. "Additionally, they have been able to keep their debt and related fixed costs in check."

In terms of fiscal volatility, most of the largest 25 cities will not experience a "sudden, unexpected drop of revenue" of more than 5% in a future downturn based on past performance. Between 2007 and 2011, the report notes, the median largest one-year decline in revenue was 2.7%, with five cities seeing no decline at all. Most cities have also built “solid reserves” over the past 10 years, including Detroit, one of the two cities identified as least prepared to weather a major recession.

Because of that, Detroit is listed as a positive “outlier” for its funding reserves, which total more than 60% of its revenue. But the report flagged other factors that affect its credit profile, including “continued challenges related to pensions, fixed costs, revenue volatility and capital needs.”

“However, Detroit has taken steps to prepare for a potential downturn: establishing an irrevocable trust to smooth spikes in pension contributions, developing a capital improvement plan that identifies a variety of sources to finance capital investments, and continuing to increase its already strong reserves,” the report says. “If these trends continue, Detroit’s overall preparedness for a future recession will be more in line with major city peers.”

Seattle, meanwhile, remains well prepared thanks to a revenue resurgence in 2011 that helped the city’s fund balance rebound, the report notes.

“Despite modest revenue softening in 2008 and 2009, the city increased spending, creating a structural operating imbalance lasting three years,” it says. “The city returned to surplus operations in 2011 after a rebound in revenues that year, and fund balance stabilized.”

Route Fifty

by Kate Elizabeth Queram

DECEMBER 29, 2019 11:29 AM ET

Kate Elizabeth Queram is a Staff Correspondent for Route Fifty.

[New Mobility Public-Private Partnerships May Address Transportation Gaps in the Future: Nossaman]

A few weeks ago, I had the privilege of again attending [CoMotion LA]. Spearheaded by John Rossant, CoMotion LA brings together leaders and innovators of new solutions to solve the mobility issues of our modern world. One of the central themes was adopting new mobility solutions to relieve congestion, an increasingly prevalent reality as populations in cities continue to grow.

During the panel on “Financing the Future: Public-Private Partnering for New Mobility Solutions,” a panel comprised of representatives from the Canadian electric school bus manufacturer Lion Electric, the shared electric scooter company Spin, the City of Pittsburgh, and the City of Detroit discussed how reliance on the gas tax is an unsustainable solution for funding transportation and mobility solutions. Revenue from federal, state, and, possibly local (depending on where you live) taxes generally go into a trust fund that pays for transportation and/or highway projects. However, revenues have been falling short for a while now and the solution is not to continually respond with raising gas taxes to make up for the shortfall.

As discussed on the panel, governments are having discussions with new mobility technology companies to address challenges such as first/last mile transport. However, when choosing the right innovation to implement, public agencies need to be mindful of integrating new mobility solutions in an equitable manner. This can be two-fold: (1) utility – a large proportion of the population, if not everyone, should be able to be use the new mobility technology to avoid marginalizing certain population sectors, and (2) accessibility – new mobility technology should be equally accessible to a large proportion of the population, if not everyone, on the same platform to avoid marginalizing certain population sectors.

The biggest message I took home from the CoMotion LA was that while mobility innovators are anxious to rapidly change the future of transportation, in order to work together with the public sector, new mobility innovators will need to demonstrate how their solution truly fills mobility gaps that are holding back large segments of the population. One of the solutions that is gaining momentum is microtransit. Nossaman is currently assisting LA Metro with its MicroTransit Pilot Project, a first of its kind public-private partnership. LA Metro has entered into contracts with three private entities who will provide customers with on-demand rides through an app or call center for first/last mile trips.

With the public sector looking to solve their transportation problems, tapping the capabilities and resources of private companies and working with them is shaping out to be the future of new mobility.

By Stephanie Kam on 12.10.2019

Nossaman LLP

House Green Bank Bill Aims to Leverage $35B in Government Funding Into $1T in Private Investment.

Dive Brief:

- Rep. Debbie Dingell, D-Mich., introduced on Thursday a House version of a Senate bill to establish a National Climate Bank, which the federal government would capitalize with $35 billion over six years.
- The bank is meant to mobilize up to $1 trillion in private investment over a decade, enabling the creation of more green banks in the country and supporting efforts of existing state and local green banks. Dingell's state green bank, Michigan Saves, has been around for nearly a decade and needs additional funding to support energy efficiency and clean energy programs, its president and CEO, Mary Templeton, told Utility Dive.
- The bill matches a Senate version introduced this summer by a group of Democratic senators. Stakeholders see the bill as an opportunity to consider the policy in broader climate solutions discussions in hopes of getting enough traction for passage in 2021.

Continue reading.

Utility Dive

by Iulia Gheorghiu

December 16, 2019

Mall Shooting Highlights Folly of AAA-Rating of CMBS Backed by a Single Mega-Mall.

Wolf here: Co-author Marc, who worked for Moody's for nine years, told me, "I want to see rating agencies improve their performance before they contribute to another meltdown."

On Black Friday, the Destiny USA Shopping Mall in Syracuse, New York was evacuated after a shooting in the food court. The following day, a knife fight broke out in the mall's entertainment complex, adding to shoppers' apprehension about visiting. This apprehension should be shared by holders of Commercial Mortgage Backed Securities (CMBS) collateralized solely by Destiny USA loans, including owners of $215 million in AAA-rated senior notes.

While one short-lived catastrophic event will not lead directly to bond defaults, the outbreaks of violence at an already troubled mega-mall cast a harsh light on rating agency decisions to assign their highest grades to structured notes wholly lacking the protection afforded by diversification.

Continue reading.

Wolf Street

by Marc Joffe • Dec 16, 2019

By Marc Joffe and Joe Pimbley, who consult for PF2 Securities. The article was first published on Expect[ed] Loss.

Berkeley's Blockchain Microbond Could Spark A Muni Market Revolution.

Berkeley, California, the progressive playground, is taking steps to pioneer the first application of blockchain technology in the municipal bond market that could transform the industry.

Effectively, Berkeley wants to crowdsource funding for community improvements. But those contributors wouldn't be making a donation, like with GoFundMe, – they'd ultimately receive their money back, with interest.

Muni bonds are the lifeblood of our communities today. Clean drinking water, roads, bridges, public transportation, and even stadiums are built with funding from the $3.8 trillion municipal bond market. Cities, states, towns, counties all issue debt to finance projects to provide the services we use every day.

Typically, munis are not a direct-to-consumer product. For the average individual investor, they're difficult to understand. Munis are less than half the size of the corporate bond market, but there are 1.5 million different types of muni bonds – 20 times the number of corporate bonds. The lack of standardization makes munis difficult for consumers to research and identify suitable bonds to purchase.

They're often purchased by households and nonprofit organizations. Although individuals may own bonds issued by their community, the average investor doesn't know what projects the proceeds support or how the money is put to work.

Trading in the secondary market must be executed by third-party dealers who handle nearly all transactions. That dynamic costs consumers more – retail investors end up overpaying and issuers lose value that could go toward their projects. Pricing inefficiencies costed investors $10 billion in price mark ups between 2005 and 2013.

Blockchain technology, or a distributed digital ledger, will allow for cost-savings and increased disclosure of secondary market trades and ongoing bond administration. It would change the way munis do business and could make them a direct-to-consumer product.

What Berkeley's planning could change that. First, by using blockchain, the bonds could be sold direct to the consumer. It would also lower a major barrier to entry for muni investments – munis are frequently sold in denominations of at least $5,000, and Berkeley is considering "microbonds" with denominations as low as $100 to maximize investor participation. Other cities, including Denver, have already issued "minibonds" – a term synonymous microbonds.

Berkeley's $2-$5 million microbond issuance is intended to finance new fire and garbage trucks for the city. It's operating under the premise that investors will want to make investments in their community and visualize that impact on the community. The message, at face-value, is appealing: make investments in your community and make money.

On a larger scale, it could help support initiatives to address housing, climate change and other infrastructure needs – all the typical uses of muni bonds. It broadens the audience and speaks to the growing desire among investors to make socially conscious investments.

Muni bonds are generally considered a safe investment, but many investors are averse to risk, slow to adapt and resistant to change.

"Governments are still figuring out how to treat this stuff, it's untested and inherently risky because we don't know how exactly it will be regulated," said Julie Hamill, attorney at Harris Bricken Hammil is the author of a white paper for the Government Finance Officers Association about blockchain technology.

Berkeley is a wealthy, populous city with the resources and an open-minded outlook, unafraid of new ideas or concepts – so it could be better positioned to make these kinds of moves toward blockchain than most.

If Berkeley moves forward with the transaction, it will be the first muni bond issuance using blockchain, and probably not the last.

Forbes

by Maria Amante

Dec 19, 2019

Maria Amante is a reporter for Debtwire Municipals, where she covers public finance in several states and higher education.

Check out my website.

Innovative Social Bonds Transaction Secures Funding for HealthRIGHT 360.

SAN FRANCISCO, Dec. 19, 2019 /PRNewswire/ — HealthRIGHT 360 announced today the successful issuance of nearly $50 million in Social Bonds. The financing will allow HealthRIGHT 360 to invest in its mission to provide integrated care to the most vulnerable and underserved communities in California.

The proceeds will also help finance renovations at and purchase equipment for HealthRIGHT 360's treatment facilities in the San Francisco Bay Area and Los Angeles County that help address local drug addiction and housing affordability challenges.

Vitka Eisen, MSW, Ed.D, President and Chief Executive Officer of HealthRIGHT 360, says: "For over 50 years, a cornerstone of our mission has been innovative leadership in the provision of vital safety net healthcare services. Our innovation continues with the Social Bonds; this is monumental for us. We are now in a much stronger financial position and have the capacity to preserve our existing services for 32,000 Californians, as well as begin to make strategic investments to expand the critical services we provide."

The transaction is the first-ever U.S. municipal Social Bond issued for a non-profit. Barclays Capital Inc. ("Barclays") served as the lead underwriter on the financing. The transaction was a two-part offering, issued via the California Municipal Finance Authority.

Tony Duong, Chief Financial Officer at HealthRIGHT 360, adds: "Our deal represents a milestone for HealthRIGHT 360 and the non-profit sector. Securing long-term financing in the capital markets with Social Bonds sends a powerful signal that social and financial returns truly can go hand-i--hand. We are delighted that some of the world's most well-known investors took this opportunity to invest in and support our mission."

Ahmad Thomas, Director in Public Finance at Barclays, who led the transaction, comments: "This was a win-win and our team could not be more proud of the result for HealthRIGHT 360. The strong level of investor interest shows the ever-increasing demand for social and environmental impact investment. HealthRIGHT 360 now has a much more secure financial future so they can focus on what they do best; serving those most in need in our communities."

HealthRIGHT 360 determined that the projects to be financed and/or refinanced with bond proceeds were social projects based on the social benefits of addressing drug addiction and homelessness. The Social Bonds designation was intended to generally comport with The Social Bond Principles promulgated by the International Capital Market Association.

About HealthRIGHT 360
HealthRIGHT 360 is a statewide healthcare organization headquartered in San Francisco, that for over 50 years has provided nonjudgmental, compassionate healthcare for people who have lived through years of homelessness, poverty, addiction, incarceration, and untreated medical and mental health issues.

Today HealthRIGHT 360 serves over 32,000 people annually, providing primary medical and preventive care to anyone seeking treatment, regardless of ability to pay.

Media contact:
Lauren Kahn, Managing Director of Policy & Com

Small Manufacturing Bonds Bill Would Raise Limit to $30 million.

Bipartisan legislation to raise the limit for small issue manufacturing bonds to $30 million has been filed by two members of the House Ways and Means Committee.

The Modernizing Agriculture and Manufacturing Bonds Act, H.R. 5422, sponsored by Reps. Stepanie Murphy, D-Fla., and Darin LaHood, R-Ill., expands the definition of manufacturing facility and eliminates restrictions on “directly related and ancillary facilities.”

The issuance limit on tax-exempt private activity bonds for Industrial Development Bonds would be raised to $30 million from the current $10 million while the limitation for first-time farmers using so-called Aggie Bonds would be raised to $552,500 from $450,000.

A similar bipartisan bill to increase the limit on Aggie Bonds was introduced in the House last month by six House members from farm states. That bill would raise the borrowing limit for first time farmers slightly less than the Murphy-LaHood bill to $543,800. Aggie bonds are issued in about 16 states with Iowa accounting for $16 million of the approximately $36.1 million issued in 2017, according to a recent survey by the Council of Finance Development Agencies.

Rep. Abby Finkenauer, D-Iowa introduced the Aggie Bonds bill with Rep. Rick Crawford, R-Ark., as her lead Republican cosponsor. The other original cosponsors are Iowa Democratic Reps. Cynthia Axne and David Loebsack along with Republican Reps. Steve Watkins of Kansas and Jeff Fortenberry of Nebraska.

The Murphy-LaHood bill, meanwhile, is meant to address the steady decline of IDB issuance because the current limit is too small to finance most projects.

“The cap was set in the early 1980s and we want it to come into modern times,” said Katie Kramer, vice president of CDFA.

A $30 million cap per issuance would be able to meet most of the demands of small to medium size manufacturers, according to CDFA’s analysis.

There also are substantial limitations on who can use the bonds and how proceeds can be used under the current law.

In 2018 only $152.8 million in IDBs were issued nationally, according to a CDFA survey. That’s a drop of more than 50% from the $316.5 million in IDBs issued in 2017.

Massachusetts was the largest IDB issuer in 2018 with $30.28 million issued, followed by Wisconsin with $28 million, Pennsylvania at $25.8 million, Georgia at $18.43 million, Indiana at $14.4 million and Iowa at $13.27 million.

The bill was introduced in previous sessions of Congress dating back to 2013 but has yet to pick up broad sponsorship among lawmakers despite its widespread popularity among issuers.

Former Republican Rep. Randy Hultgren of Illinois, who lost his re-election bid in 2018, and Democratic Rep. Richard Neal of Massachusetts, who has stepped up to become chairman of the Ways and Means Committee, sponsored the bill previously.

Neal, a former mayor of Springfield, Massachusetts sponsored a number of municipal bond related bills in previous Congresses, but hasn't since becoming chairman of the committee with jurisdiction over tax legislation. Instead, Neal has looked to members of his committee to take over sponsoring bills that he previously championed.

"Our farmers and manufacturers deserve to have innovative and updated financing tools to invest in their local community and hire more workers," Murphy said in a press statement announcing her sponsorship of the bill.

Murphy said the legislation "will modernize the way farmers and manufacturers across the country acquire capital, providing them with the resources they need to grow, create more jobs, and bring their businesses into the 21st century."

LaHood said farming and manufacturing "are critical to the economic success of the constituents I represent in central and west-central Illinois."

"Our legislation will help entrepreneurs and first-time farmers receive the financing they need to grow, create good-paying jobs, and bolster our economy in the Midwest," LaHood said.

No Senate version has been introduced in this Congress.

A bipartisan Senate version was introduced in September 2016 and again in March 2017 by Sens. Sherrod Brown, D-Ohio and David Perdue, R-Ga.

Brown is awaiting a Republican co-sponsor before he reintroduces the Senate bill.

By Brian Tumulty

BY SOURCEMEDIA | MUNICIPAL | 12/19/19 01:15 PM EST

Funded Ratio for 100 Largest U.S. Public Pensions Climbs to 73.4%, According to Milliman Estimates.

Nearly one-third of PPFS plans lowered interest rate assumptions since 2018 study

SEATTLE, Dec. 23, 2019 /PRNewswire/ — Milliman, Inc., a premier global consulting and actuarial firm, today released the results of its 2019 Public Pension Funding Study (PPFS), which analyzes funding levels of the nation's 100 largest public pension plans, including an independent assessment on the expected real return of each plan's investments.

For Milliman's 2019 PPFS, the estimated aggregate funded ratio of the nation's largest public pension plans is 73.4% as of June 30, 2019, with the estimated combined investment return at 7.34% in Q1 2019 and 2.66% in Q2, and aggregate plan assets reaching $3.84 trillion as of June 30. Total Pension Liabilities (TPL) for these plans crossed the $5 trillion mark for the first time, and as of June 30, 2019 Milliman estimates the PPFS aggregate TPL to be $5.23 trillion.

"Thanks in large part to strong market performance in the first half of 2019, plan assets continue to keep pace with liability growth, buoying public pension funding," said Becky Sielman, author of Milliman's Public Pension Funding Study. "But we're also seeing plan sponsors continue to inject conservatism into their interest rate assumptions, with nearly one-third of these plans lowering rates since the last study. While interest rate assumptions of 8.00% were once the norm, 85 of the public pensions in our study now have assumptions of 7.50% or below."

To view the full Milliman 100 Public Pension Funding Study, go to http://www.milliman.com/ppfs/. To receive regular updates of Milliman's pension funding analysis, contact us at pensionfunding@milliman.com.

About Milliman
Milliman is among the world's largest providers of actuarial and related products and services. The firm has consulting practices in healthcare, property & casualty insurance, life insurance and financial services, and employee benefits. Founded in 1947, Milliman is an independent firm with offices in major cities around the globe. For further information, visit milliman.com.

About the Milliman Public Pension Funding Study
This Milliman Public Pension Funding Study is based on the most recently available Comprehensive Annual Financial Reports, which reflect measurement dates ranging from June 30, 2015, to December 31, 2018; 91 are from June 30, 2018, or later. For the purposes of this study, the reported asset allocation of each of the plans has been analyzed to determine an independent measure of the expected long-term median real rate of return on plan assets. The sponsor-reported Total Pension Liability for each plan has then been recalibrated to reflect this independently determined investment return assumption. This study therefore adjusts for differences between each plan's reported discount rate and an independently calibrated current market assessment of the expected real return based on actual asset allocations. This study is not intended to price the plans' liabilities for purposes of determining contribution amounts or near-term plan settlement purposes nor to analyze the funding of individual plans.

Muni Bond Defaults Remain Rare.

In August, Moody's Investors Service released its annual municipal bond market snapshot, *US Municipal Bond Defaults and Recoveries, 1970-2018*, with updates through 2018. The report continues to affirm two hallmark benefits offered by muni bonds. First, municipal bankruptcies remain rare overall, even though they may have become more common over the last 10 years. (There were no rated municipal defaults in 2018.) Second, muni bonds continued to be highly rated in 2018, with more issuers upgraded than downgraded. (According to Moody's, though, on average, the size of the downgrades was larger than for the upgrades.)

Last year, we noted that the report featured a significant update to Moody's entire dataset extending back to 1970 and that the recalculation Moody's undertook had not only rendered key metrics more meaningful but also offered greater explanatory power. (This enabled more powerful inferences regarding long-term trends.) One important "observation" noted in this year's report was that, over the 48-year study period: "any one default may only reflect the idiosyncrasies of that individual credit, and not be representative of any general sector trend."

Muni Bond Defaults and Bankruptcies Remain Rare
The report noted, once again, the fundamental difference between municipal and corporate credits.

While the five-year all-rated cumulative default rate (CDR) of municipal bonds throughout the study period (1970-2018) might have increased a tiny bit to 0.10% (1970-2017: 0.09%) it still remains quite low. Likewise when compared to the five-year CDR of 6.6% for global corporates over the same time period. There were neither any rated municipal defaults in 2018, nor any new defaults in Puerto

Rico (although many Commonwealth of Puerto Rico entities remained in default during the year). There was, however, one unrated default during the same period.

While there may have been a dearth of new rated defaults in 2018, Moody's did note that there had been "some notable developments concerning default, bankruptcy and recovery," not least in the context of the defaults in Puerto Rico. The rating agency went so far as to say: "One remarkable development in the past year is the number of court rulings that will have bearing on future municipal bankruptcies." It further noted that while pledge still matters, it might not shield against loss in either default or bankruptcy—especially when the payment of pensions is involved. (Muni investors will certainly have to bear this in mind going forward.)

Ongoing Stabilization in Muni Bonds
The report also notes, for the second year running, that nearly a decade after the Great Recession (2007-2009), the credit quality of the municipal bond sector is now stable. It has been aided in part by growth and economic recovery in many regions of the U.S. For the third year running, in 2018, muni bond rating upgrades outweighed downgrades (480 vs. 392), but there were fewer rating changes than in prior years.

In contrast with the trend of growing positive drift in 2017 (positive since late-2015), ratings drift,1 at 0.003% per credit, was nearly flat in 2018. The trend had been generally negative since mid-2008, and reached a low of -0.083 notches per credit in 2012. In addition, volatility, at 0.09 vs. 0.11 notches per credit in 2017, dropped 23% in 2018. The report added that the municipal sector overall is highly rated, with approximately 92% of all the municipal credits Moody's rates falling into the A category or higher as of the end of 2018. Further, at the end of 2018, the median rating for U.S. municipal credits was Aa3. This stood in stark contrast to the median rating for global corporates, which was Baa3.

Conclusion
As we concluded in our review last year, although it is still a struggle to obtain the same amount of timely disclosure from issuers of municipal bonds as one sees in other asset classes, the pure empirical evidence suggests that muni bonds continue to offer a fiscally sound vehicle for deriving an income stream free from federal, and in some cases, state taxes.

If one looks at defaults alone over the past 48 years, according to Moody's report, across all sectors there have been only 113 defaults in the total amount of a little over $72 billion. Of this figure, Jefferson County, Alabama and the city of Detroit, Michigan accounted for approximately $11 billion and Puerto Rico some $55.5 billion (combined $66.5 billion). There are more than 50,000 different state and local governments and other issuing authorities.

There are, however, as always, caveats. As Moody's states in the report's Introduction: "The once-comfortable aphorism that 'munis don't default' is no longer credible: rating volatility, rating transition rates and cumulative default rates (CDR) have all increased since 2009." The sector does face challenges. These include, among others, democratic shifts (populations both aging and relocating—affecting tax receipts), "substantial increases in pension and retirement health care leverage" and "the associated but new exposure to equity markets."

Moody's goes on to describe the sector's exposure to the equity markets as "unprecedented" and requiring attention. For state and local governments, this exposure has been gained through their pension fund trusts. The concern for Moody's is not only their resulting exposure to "financial market volatility in general," but also the size of this exposure, which is both significant and "a feature never before seen in the U.S. public sector."

Despite this, we still believe that municipal bonds remain important to the core strategy of constructing an individual portfolio.

by VAN ECK GLOBAL on DECEMBER 21, 2019

By Michael Cohick, Senior ETF Product Manager for VanEck Global

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[Teachers Pay High Fees for Retirement Funds. Unions Are Partly to Blame.]

Groups representing municipal employees and teachers are often paid to endorse investment products

The pitch from the president of the Indian River County teachers union couldn't have been clearer.

Liz Cannon, who heads the Indian River chapter of the Florida Education Association, urged union members to buy retirement investments from Valic Financial Advisors Inc. through a firm owned by the union. That way "we also make money," she said in a November 2017 newsletter, through regular dividends.

What Ms. Cannon didn't mention was that investments from Valic, a unit of giant insurance company American International Group Inc., can carry high costs that may translate to a smaller nest egg when teachers retire.

The setup is one of an array of similar deals in which unions and other groups get income from endorsements of investment products and services—often at the expense of teachers and other municipal employees.

Continue reading.

The Wall Street Journal

By Anne Tergesen and Gretchen Morgenson

Dec. 18, 2019 10:57 am ET

Hilltop's Kozlik 'Cautious' on State, Local Government Debt.

Tom Kozlik, HilltopSecurities head of municipal strategy and credit, discusses what he sees as the top themes in the municipal bond market with Bloomberg's Taylor Riggs on "Bloomberg Markets."

Watch video.

Bloomberg MarketsTV Shows

December 27th, 2019, 8:37 AM PST

Muni Bond Party Should Continue In 2020: BI’s Kazatsky (Radio)

Eric Kazatsky, Municipal Strategist for Bloomberg Intelligence, on why the municipal bond party should continue in 2020. Hosted by Lisa Abramowicz and Paul Sweeney.

Running time 07:33

Play Episode

Bloomberg Intelligence

December 26, 2019 — 8:18 AM PST

Death Bell Tolls For Private Colleges, Hits Bondholders (Radio)

Amanda Albright, municipal bond reporter for Bloomberg, on the death bell tolling for private colleges. Hosted by Lisa Abramowicz and Paul Sweeney.

Running time 04:42

Play Episode

Bloomberg

December 18, 2019 — 8:06 AM PST

Low Sovereign Yields Driving Global Buyers Into Munis (Radio)

Jeff Burger, Senior Portfolio Manager for U.S. Municipal Bond strategies at Mellon Investments, on record muni flows and 2020 outlook. Hosted by Lisa Abramowicz and Paul Sweeney.

Running time 05:48

Play Episode

Bloomberg Business

December 18, 2019 — 8:38 AM PST

U.S. in 'Sweet Spot' for Taking Credit Risk, Federated's Gallo Says.

RJ Gallo, head of the muni bond group at Federated Investors, discusses the outlook for municipal bonds and the credit market in 2020 with Bloomberg’s Taylor Riggs on “Bloomberg Markets.”

Watch video.

Bloomberg MarketsTV Shows

December 18th, 2019, 8:07 AM PST

Taxable Munis? They're Worth a Look.

***Sound* describes the credit quality. But it doesn't do justice to the stellar performance.**

To herald this new decade, I decree that we quit bemoaning the Great Recession and credit crisis of 2008–09 and its many calamities. It happened, it was costly, we learned something about defaults and diversification—and it's old news. But before we lock the door on those dark days, I offer a shout-out to one of the meltdown's few rewarding legacies: the taxable municipal bond.

Yes, there is such a thing. A handful are general obligation bonds, issued by municipalities, but the vast majority are construction or infrastructure bonds issued and backed by a public entity. Some 15% of fresh state and local debt today pays interest subject to federal income taxes, and the yields to maturity are considerably higher than Treasuries or regular municipals—often, over 3% for 15-year bonds or 5% for 20-year debt. In 2019, taxable muni issuance spiked amid high demand, and that has carried into 2020 because of the hunt for yield and these bonds' powerful appeal for IRAs, pension funds and foreign buyers who would gain no advantage from tax-frees anyway.

Overseas demand is often the trigger for issuers to add a smaller taxable portion to a large tax-exempt offering. After all, a 3.2%, 15-year bond rated A+ and backed by, say, an international airport's terminal and parking revenue is an easy sell in negative-yield Europe. Taxable muni issuers have recently included the Port Authority of New York and New Jersey, the Dallas–Fort Worth airport, the Multnomah County, Ore. (Portland-area) school district, and several state college and university systems.

Continue reading.

Kiplinger's Personal Finance

By Jeffrey R. Kosnett

December 27, 2019

Fitch Ratings: Affordability and Deleveraging Key for U.S. Public Power in 2020

Fitch Ratings-New York-12 December 2019: U.S. public power utilities are well positioned financially and operationally headed into next year, though Fitch Ratings' 2020 outlook report points to some uncertainty around the 2020 U.S. presidential election and broader climate issues.

The Rating Outlook for the public power sector is Stable. "Continued deleveraging driven by robust rate-setting policies, benign operating conditions and declining capital investment supports Fitch's stable outlook for the U.S. public power sector," said Managing Director Dennis Pidherny.

Low interest rates and robust access to the capital markets will likely continue unabated for the capital-intensive public power sector. A sustained period of lower rates should keep financing costs manageable and ease upward pressure on electric rates. Additionally, more than half of the municipal sector debt issued in 2018-2019 was earmarked for refunding. The benefits of debt refunding should continue through 2020, reflecting the Fed's changed course on monetary policy.

However, uncertainty surrounding the 2020 election and the potential for more aggressive environmental mandates could disrupt longer term performance. A lack of strong federal leadership on carbon emissions reduction has prompted many states to forge their own paths to address climate issues. "Implementation of competing Green New Deal proposals or the prospect that an increasing number of state mandates will become applicable to public power systems are Fitch's primary concerns," said Pidherny. "Material compliance costs and required investment could strain service affordability and challenge the trend of deleveraging observed in recent years."

"Fitch Ratings 2020 Outlook: U.S. Public Power and Electric Cooperatives" is available at www.fitchratings.com

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Fitch Ratings: Outlook Stable for U.S. Water and Sewer Utilities in 2020

Fitch Ratings-Austin-12 December 2019: U.S. water and sewer utilities are in solid fiscal shape headed into next year with infrastructure a likely point of interest leading into the 2020 presidential election, according to Fitch Ratings in its 2020 outlook report.

"Water and sewer utilities continue to enact steady rate adjustments to accommodate operating cost increases and capital needs," said Managing Director Doug Scott. "Utilities are also well-positioned to absorb any temporary business variations given their robust balance sheets."

The water and sewer the industry will be paying close attention to infrastructure proposals of the presidential candidates headed into the 2020 election. Based on EPA's latest figures, $740 billion in capital investment will be necessary to address water and sewer needs over a 20-year horizon. The new WIFIA program has afforded EPA the ability to leverage appropriations at an accelerated rate via credit subsidies compared to traditional state revolving fund loan programs. "Dramatic escalation in water and sewer infrastructure appropriations is unlikely, though WIFIA program expansion is a distinct possibility," said Scott.

Increased volatility in weather extremes has the potential to escalate sector capital needs as utilities seek to harden assets and enhance water supply capability to ensure service delivery. Added capital demands would likely lead to some increase in moderate sector leverage levels and further erode sector affordability levels.

'Fitch Ratings 2020 Outlook: U.S. Water and Sewer Sector' is available at 'www.fitchratings.com'.

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[Fitch Ratings: Problems to Persist for U.S. Higher Education in 2020]

Fitch Ratings-Chicago-10 December 2019: U.S. colleges and universities will continue to struggle against operating pressures and numerous other industry challenges headed into next year, according to Fitch Ratings in its 2020 outlook report.

Fitch maintains its negative sector outlook for 2020 as tuition growth continues to soften. Stagnancy in both high school graduation rates and state and federal funding levels are also key pressure points for the sector, according to Director Emily Wadhwani.

'Online and non-traditional educational alternatives are becoming more commonplace, which could serve as an additional disruptor for a sector already grappling with numerous other pressures,' said Wadhwani. 'State support for schools, while steady, is still below pre-recession levels and not likely to reverse course with states grappling with ongoing revenue volatility, continued demands for infrastructure investment, and projected slower economic growth.'

While these developments are likely to pressure margins for colleges and universities across the sector, the good news is that they are not expected to trickle down into rating performance for Fitch-rated schools. Fitch maintains a Stable Outlook on 91% of its ratings headed into 2020 with Positive Outlooks for another 4% in Fitch's portfolio. That said, 'the credit gap will also continue to widen next year between financially stronger colleges and schools that are more reliant on tuition and/or in demographically challenged or competitive markets,' said Wadhwani.

'Fitch Ratings 2020 Outlook: U.S. Public Finance Colleges and Universities' is available at 'www.fitchratings.com'.

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Fitch Ratings: Financing Evolving for North American Energy Infrastructure in 2020

Fitch Ratings-New York-11 December 2019: The evolution in financing for energy infrastructure projects will continue into next year, according to Fitch Ratings in its 2020 outlook report.

Fitch is maintaining its stable outlook for North American Energy Infrastructure with most project financings reflecting fixed-price off-take agreements that minimize revenue and margin volatility. However, according to Andy Joynt, Senior Director at Fitch Ratings, shifts are already underway in the typical energy project finance paradigms. “New off-taker types are becoming commonplace and merchant exposure is being incorporated into portfolio financings,” said Joynt. “Additionally, newer technologies like battery storage are also gaining investor confidence and may increasingly be paired with solar or thermal generation in future projects.”

This evolution comes during an increasingly competitive environment for contracts with PPA pricing and terms steadily falling. This is prompting developers to seek finance projects with re-contracting risk on the table. “Even in the absence of a replacement power purchase agreement, a project could sell energy into the wholesale market but this introduces revenue volatility that erodes credit quality,” said Joynt.

Heading into 2020, U.S. liquefied natural gas (LNG) export capacity now exceeds 6 Bcf/day with a handful of projects entering commercial operation in the second half of this year. Asia in general is considered the biggest market opportunity with China a massive consumer of natural gas. However, demand has not materialized due to the ongoing trade war between the U.S. and China. “An ease of trade tensions could lead to a new wave of LNG contracts and trigger final investment decisions on some pending new projects or expansions,” said Joynt. “Conversely, LNG suppliers may look to Europe and Latin America if tensions linger.”

Fitch Ratings 2020 Outlook: North American Energy Infrastructure is available at www.fitchratings.com.

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Fitch Ratings: Relief for U.S. State Pension Liabilities Not Likely to Last

Fitch Ratings-New York-10 December 2019: Rising state pension liabilities reversed course this past year, although this is likely little more than a short-term breather, according to Fitch Ratings in its latest annual state survey.

Fitch's median state pension liability burden fell to 3.1% of personal income in fiscal 2018 from 3.6% in fiscal 2017. States are also seeing a median 6.7% drop in their adjusted net pension liabilities. Despite the improved numbers, they do not reflect a long-term improvement in states' pension situations, but rather the states' exposure to short-term market fluctuations now inherent in pension accounting, according to Douglas Offerman, Senior Director at Fitch. "The lower fiscal 2018 state net pension liabilities are capturing the lagged recognition of strong market gains most pension plans experienced as of their 2017 measurement dates," said Offerman.

State debt burdens drifted lower with the median burden of state direct debt falling slightly to 2.3% of personal income in fiscal 2018 from 2.4% in fiscal 2017. This move, however, is more reflective of a lasting trend. "Unlike with pensions, the drop in the burden of bonded debt continues a longer-term decline underway in many states," said Offerman. With both debt and pensions lower in fiscal 2018, the median state long-term liability burden has also declined year-over-year to 5.7% of personal income from 6%.

Illinois continues to carry the heaviest liability burden (27.5% of personal income) followed by Connecticut, Kentucky, New Jersey, Alaska and Hawaii (rankings unchanged year-over year). By contrast, 37 states have what Fitch views as low liability burdens with Nebraska topping the list at only 1.7% of personal income.

Fitch's "2019 State Pension Update" is available at www.fitchratings.com.

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Fitch Ratings: U.S. Transportation Infrastructure Growth to Mirror Slower GDP in 2020

Fitch Ratings-New York-09 December 2019: U.S. transportation infrastructure growth will continue moving more or less in step with leveling off GDP next year, according to Fitch Ratings' 2020 outlook report.

Volume growth remains favorable for U.S. airports, ports and toll roads and will remain largely tethered to U.S. GDP movement, which Fitch projects will fall below 2% for 2020. That said, "Some softness in growth may take hold to the extent issuers are exposed to global economic markets and protectionist trade policies," said Senior Director Scott Zuchorski.

Likely to pace volume growth will be U.S. airports, with Fitch projecting 2%-3% thanks to continued healthy demand for travel. Passenger traffic will also remain healthy for both large and small hub airports following a spike this past year. One outlier to watch next year will be the continued grounding of the Boeing 737 Max.

Moving more closely in tandem with U.S. GDP next year will be U.S. toll roads and ports. Stronger performance is expected for toll roads in the Southeast and Southwest regions in particular, due to stronger demographic trends versus the U.S. overall. Meanwhile, volumes at East Coast ports are likely to continue outpacing those of their West Coast counterparts due to their higher exposure to Chinese tariffs. Over time, revenues may start to decline at West Coast ports the longer the trade impasse with China continues.

Two other key developments are worth close watch next year, the first being the fate of PPPs as developer risk allocation led to some contractors exiting the U.S. market. The second is emerging technologies like driverless cars and connected vehicles. Parking assets and managed lanes appear most vulnerable to this change, though more widespread risk is unlikely to manifest for at least the next decade.

Fitch's "2020 Outlook: U.S. Transportation Infrastructure" is available at www.fitchratings.com.

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Fitch Rtgs: Not-for-Profit Hospitals Outlook Stable in Face of Challenges

Fitch Ratings-New York-10 December 2019: Hospitals' and healthcare systems' ability to respond to operational challenges by cutting costs and improving efficiency has placed these entities on surer footing for the continued headwinds they will face in 2020, says Fitch Ratings. Overall balance sheet stability and slight improvements in operational performance reflect the sector's adaptation to pressures, such as high levels of labor and pharmaceutical costs, cost and implementation risks of moving toward more value-based and at-risk reimbursement models, a shifting payor mix, commercial insurance rate increases, and competition from non-traditional market entrants. Most providers have begun to effectively align their cost models to revenue pressures, despite these challenges. Fitch changed its sector outlook from Negative to Stable for 2020 and is maintaining a Stable Rating Outlook for healthcare issuers in 2020.

We believe many providers will continue to pursue consolidation and alignment in order to extract greater efficiencies and gain contracting leverage with payors and suppliers. Although size and scale alone do not necessarily result in success, further consolidation is a logical outcome given current industry pressures.

The increase in the share of the US population over age 65 will generally have a negative longer-term effect on payor mix as seniors shift from commercial insurance to Medicare. The aging population should provide an uplift in volumes, as use rates increase proportionally with age; however, this added volume will only be beneficial if providers can manage to break-even, or better, on Medicare rates. Commercial, or managed care, contract negotiations are critical for providers as they seek to offset the effects of comparatively weaker governmental reimbursement with favorable commercial contracts.

The decades-long focus on outpatient services compared with inpatient services has not moderated, resulting in a mismatch of fixed costs and declining inpatient volume. The transition from volume to value-based reimbursement is a longer-term adjustment but in the short term will result in margin pressures for hospitals as they invest in new systems and see a decline in overnight admissions.

Non-traditional healthcare entrants will continue to be a disruptive factor over the medium to long term and are likely to change the way individuals interact with the sector. Technology and large retail companies, with potentially deeper pockets, sophisticated and consumer friendly distribution channels, and data platforms they are able to leverage are expected to make further inroads into pharmacy and low-acuity medical services. This will result in a more competitive operating environment across the patient spectrum.

Balance sheet measures have reached levels not seen since before the Great Recession of 2007-2009. The sector benefited from favorable investment conditions, positive cash flow, and generally manageable spending on capex. As a result, balance sheet strength has largely mitigated operational pressures faced by hospitals in recent years.

While policy direction in the next few years will be determined by the 2020 US elections, the acute care sector would face significant challenges regardless of the outcome. Any systemic change, whether it be the dismantling of the Affordable Care Act or the implementation of a 'Medicare for All' plan, would take some time to implement, and places uncertainty on whether or not our Stable sector and Ratings Outlooks will persist beyond 2020.

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Additional information is available on www.fitchratings.com. The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

Fitch Ratings: U.S. State and Local Governments to Hold Steady in 2020

Fitch Ratings-New York-10 December 2019: Stability is in the cards for most U.S. state and local governments next year even with a slowing economy making revenue forecasting more difficult, according to Fitch Ratings in its 2020 outlook report.

Fitch has a stable outlook for both sectors in 2020 despite uncertainties related to economic growth, the effect of federal policy, and spending demands for labor and infrastructure. ‘Governments will continue to exercise their considerable control over revenues and spending to maintain sound financial resilience,’ said Arlene Bohner, Fitch’s Head of U.S. state and local governments.

Fitch has identified three states to watch in 2020 that could see tangible changes in credit quality. ‘Alaska and Illinois both face potential constitutional amendments that could alter Fitch’s assessments of credit quality, while Kentucky will have a gubernatorial transition as it deals with ongoing budgetary challenges,’ said Bohner.

Alaska will face key questions on gubernatorial proposals that may weaken operating flexibility. Alaska’s governor will continue to seek a full dividend payment for residents and legislative approval for a set of constitutional amendments, which, if enacted, could weaken the state’s budgetary operating flexibility and negatively affect the state’s Issuer Default Rating.

Illinois voters will decide in November on a constitutional amendment to allow a graduated individual income tax. The credit implications depend on whether Illinois uses any increased revenues to address structural budget challenges, or if the state can adequately adjust its budget to work toward structural balance if the amendment fails.

Kentucky’s new Democratic governor will need to work with the Republican-controlled legislature to address persistent budgetary challenges with enactment of a new biennial budget due in the first half of 2020. Maintaining structural spending while reducing reliance on non-recurring budget measures could prove challenging if the political environment deteriorates.

‘Fitch Ratings 2020 Outlook: U.S. States and Local Governments’ is available at www.fitchratings.com.

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CUSIP Request Volume for Corporate and Municipal Debt Ebbs in November.

NEW YORK, NY, December 10, 2019 – CUSIP Global Services (CGS) today announced the release of its CUSIP Issuance Trends Report for November 2019. The report, which tracks the issuance of new security identifiers as an early indicator of debt and capital markets activity over the next quarter, found monthly decreases in CUSIP request volumes for corporate and municipal debt and a slight increase in requests for corporate debt identifiers in November.

Read Report.

16% Monthly Decline in Muni Requests Puts Crimp in Robust 2019 Issuance.

“The low interest rate environment has spurred historically high volumes of new security issuance across several key asset classes this year,” said Gerard Faulkner, Director of Operations for CUSIP Global Services. “While the November slowdown in muni issuance will likely take us off track for a record-setting year in 2019, we’re still seeing significant volumes on the whole this year.”

Read Press Release.

New Approaches to Large-Scale Green Stormwater Infrastructure Investment Build Climate Resilience.

More frequent and intense rainstorms. Elevated heat and humidity. High water levels and increased shoreline erosion. The realities of climate change, combined with aging and outmoded stormwater infrastructure, create a crisis for Great Lakes stormwater managers.

The good news is many of these challenges can be mitigated through the construction of green stormwater infrastructure–constructed wetlands, porous concrete, and bioswales that help treat stormwater and take the pressure off traditional gray infrastructure like sewers, pipes, pumps, and tunnels. But communities are challenged to fund and implement projects at the scale needed to address the crisis.

Fortunately, new thinking and approaches to funding and constructing green stormwater infrastructure are emerging. These methods, which combine market principles with community benefits, are upending the traditional economics and practice of building green stormwater infrastructure and are bringing climate resilience within reach.

Continue reading.

P3 GREAT LAKES INITIATIVE | TUESDAY, DECEMBER 10, 2019

The Jefferson County, Alabama, Bankruptcy.

The Jefferson County, Alabama, bankruptcy case was slightly more unusual than other municipal bankruptcies, in which the financial downturn severely impacted a municipality's ability to meet its expenditures.

The bankruptcy case of Jefferson County, Alabama, was the epitome of corruption and bribery amongst elected officials, contractors, county employees, and bankers involved in the county's sewer-related debt issuance. This one public work project, often referred to as "the Taj Mahal" of sewage systems, became the epicenter that led to the county filing for bankruptcy and, ultimately, two dozen people, including elected officials, contractors and county employees went to jail for bribery and fraud charges.

In this article, we will take a closer look at the Jefferson County, Alabama, bankruptcy case and what the bankruptcy settlement means for investors and creditors.

Continue reading.

municipalbonds.com

by Jayden Sangha

Dec 11, 2019

How an $8 Billion Municipal Bond Fund Finds Opportunity in a 'Quirky' Market.

Fresh out of college in 1991, Ben Barber joined the management training program at Franklin Templeton in San Mateo, Calif., and rotated through different departments. In the end, it wasn't emerging markets or the up-and-coming technology sector that captured his interest, but municipal bonds.

“I love the aspect of you’re financing infrastructure, generally for the common good, whether it’s airports, roads, schools, or hospitals,” says Barber, 50, who is co-head of municipal investments for Goldman Sachs Asset Management, or GSAM.

The $3.8 trillion muni market is the mechanism by which states, counties, municipalities, and other government entities fund operations and public-works projects. The nuances of every issuer, sector, project, and tax treatment make for a “quirky” market where every deal is different.

That’s all the better for Barber, his co-managers Scott Diamond and Joe Wenzel, and their 34-person team to look for upside. Over the past decade, their $7.7 billion Goldman Sachs Dynamic Municipal Income fund has returned an average of 4.6% annually, better than 91% of its peers, and 1.5 percentage points, per year, better than its benchmark.

The fund (ticker: GSMIX) focuses on national tax-exempt bonds but has a broad mandate. “We want to be up and down the entire yield curve, the entire credit spectrum, and across different structures, and we want to be national,” says Barber.

Relative to the rest of the bond market, munis look like a good deal. Default rates tend to be lower than their corporate counterparts, but after-tax equivalent yields are higher. The net supply of new issues is down slightly this year, while demand remains strong. Individual investors own two-thirds of all muni assets—that adds stability to the market but also leaves room for Barber’s team to capitalize on inefficiencies.

After joining the muni team at Franklin Templeton, Barber followed his boss and mentor to GSAM and was named head of the muni team in 2002. Barber—who grew up feeding chickens and milking cows on a hobby farm in the Central Valley of California—is based in San Francisco. The rest of the team works in Salt Lake City and New York, making it easier to cover a market that comprises tens of thousands of issuers around the country.

State government general obligation bonds represent the largest slice of the fund at nearly 12% of assets, and not surprisingly. These perennial issuers account for more than a quarter of the fund’s benchmark. While state bonds are a portfolio staple, their prices can fluctuate on news of state budgets, economic outlooks, and natural disasters. “Our job is to figure out if it’s just noise,” Barber says.

Meanwhile, investors often paint muni bonds with a broad brush—and Barber has been able to take advantage of that. Take Illinois, where a state pension crisis has led to persistent downgrades of state-issued muni bonds, which now sit just above junk status. Investors have turned a skeptical eye to other issuers throughout the state as a result, Barber says. Bonds issued for Chicago O’Hare International Airport, for example, trade at a discount to comparable bonds in other states, says Barber. The fund recently had about 12% of its assets in “all things Illinois,” though only 5% of that exposure is tied directly to the state.

Historically, taxable muni bonds have been the minority, accounting for less than 10% of the market. A provision in the 2017 tax-cut law—which prohibits states from advanced refinancing of tax-exempt bonds—coupled with low interest rates have prompted many states to refinance with taxable bonds. In response, the fund has bought tax-exempt bonds with short calls—a short period before the issuer can cancel the bond—which are more likely to be refinanced.

State munis offer no shortage of opportunity, “but a much more interesting part of the market are the smaller issuers that may come to the bond market once or a handful of times at most," says Barber. Airports, sports stadiums, and water-treatment facilities fall into this category. So do hospitals, which recently accounted for nearly 8% of the fund's assets.

Tobacco-settlement bonds, meanwhile, make up 3% of the fund. These high-yield, long-term bonds were issued by states and are backed by annual payments from tobacco companies as part of the landmark 1998 legal settlement that resolved 46 states' lawsuit against the industry's major manufacturers. More than two decades later, these bonds are influenced by everything from cigarette sales (settlement payments are based on U.S. cigarette consumption) to broader interest and inflation rates. Recently, the fund has focused on zero-coupon tobacco bonds, which don't pay out interest but have more potential for price appreciation. The sector "requires very specific analysis to succeed," Barber says.

The fund can own up to 30% of its assets in junk-rated munis, though Barber and his team have trimmed their high-yield exposure to 16% of assets, down from a high of 23% in 2017. The reason: valuations. As more investors have ventured into high-yield debt, the difference, or spread, between yields on these lower-rated bonds and comparable investment-grade bonds has narrowed.

Fortunately, the team has the leeway to find deals in many places, including Puerto Rico. It has for years owned Cofina bonds issued by the sales-tax financing authority. Bonds maturing in 2058, for example, yield 4.3%. Recent restructuring of the bonds prompted the team to add to the position, which is the fund's third largest. Yes, Puerto Rico has had its issues, "but bonds tied to sales tax tend to be more stable than any other type of bonds," says Barber. •

Barron's

By Sarah Max

Dec. 11, 2019

Municipal Bonds: Relative Value Versus Absolute Yield

Bloomberg Intelligence's Eric Kazatsky examines the historical reaction of municipal bonds to Federal Reserve rate decisions and looks at relative value versus absolute yield in the municipal bond market. He speaks with Bloomberg's Taylor Riggs on this week's "Muni Moment" on "Bloomberg Markets."

Watch video.

Bloomberg Markets TV Shows

December 11th, 2019, 8:25 AM PST

Wall Street's Muni-Bond Bankers Brace for a Record Year in 2020.

- **BofA, Citi, Oppenheimer expecting more than $400 billion**
- **Bond sales surge as governments seize on lower interest rates**

The Federal Reserve's decision to keep interest rates low is providing stimulus to a once contracting Wall Street business: underwriting municipal bonds.

State and local government debt sales may surge to a record in 2020, extending this year's boom, as borrowing costs hold near the lowest in over half a century, according to forecasts from some of the market's biggest underwriters. That marks a welcome shift for banks that saw bond work dry up in 2018 after President Donald Trump signed legislation that blocked new tax-exempt debt sales for a major type of refinancing known as an advance refunding.

Continue reading.

Bloomberg Markets

By Danielle Moran

December 12, 2019, 10:30 AM PST

Ex-JPMorgan Banker's Career Gamble Pays Off in Muni-Bond Blitz.

- **Mark Melio started firm in 2009 to advise hospitals on debt**
- **Refinancing boom vaults his firm 93 spots to 11th biggest**

A frenzy of debt sales in the $3.8 trillion municipal-bond market is handing a huge win to an ex-banker's career gamble a decade ago.

Mark Melio, who once led JPMorgan Chase & Co.'s public finance department, struck out on his own in 2009 to start a small financial advisory firm catering to health-care systems. This year, that decision is paying off as hospitals seize on low interest rates to refinance old debt or raise money for new projects. His firm, Melio & Co., is having its best year on record and has vaulted 93 spots to eleventh place in Bloomberg's ranking of municipal-bond advisers.

Melio & Co.'s rise marks a coup in an industry increasingly dominated by PFM Financial Advisors and Public Resources Advisory Group, which together advised on nearly a third of municipal-bond deals in 2019.

Bloomberg ranking of financial advisers
It only took 20 deals for Melio's business to leap in the rankings, thanks to massive issues from juggernauts like CommonSpirit Health and the Cleveland Clinic.

Hospitals have sold $28.4 billion in debt this year, a nearly 38% increase from a year earlier. Much of those sales have been driven by decisions to refinance their debt with taxable securities, a tactic that's taken hold because of new limits on tax-exempt refinancings and low interest rates that have made such deals viable.

Melio said he has no plans to expand his advising business beyond health care but does plan to hire more people. His team right now includes Aimee Trepiccione, a former health-care banker for JPMorgan, and Matt Swafford, a former Morgan Stanley banker.

"That gives the clients some insight in how the banks are thinking," he said in an interview.

Melio said his health care advising business has been a "gratifying" shift from his career in public finance at JPMorgan and Goldman Sachs Group Inc., an industry he was critical of in a 2016 memoir.

"Personally, it makes me feel good to do work on a children's hospital, for instance," he said in the interview. "You feel like you're contributing something meaningful."

Bloomberg Markets

By Amanda Albright

December 12, 2019, 6:47 AM PST

As Tiny Underwriters Die, Brothers' Deal Keeps Firm in Family.

- **McLiney, a family owned firm, merging with Texas's Samco**
- **Small underwriters are disappearing in face of competition**

McLiney and Company, a Kansas firm that's been run by the same family for 54 years, is joining the ranks of small, stand-alone municipal-bond underwriters that are disappearing as Wall Street Goliaths expand their dominance of the $400 billion-a-year business.

But under a deal struck to merge with a rival, it's not entirely losing its blood ties.

The Mission, Kansas-based McLiney, which was founded in 1965 by the son of municipal-bond banker George McLiney Jr., said on Tuesday that its seven employees would join Samco Capital Markets, a larger underwriter based in Austin that specializes in Texas debt.

Continue reading.

Bloomberg Deals

By Amanda Albright

December 11, 2019, 7:33 AM PST

Why BlackRock Is Still Bullish on Munis After Market's Big Gains.

- **Trump tax law helped set off record influx into mutual funds**
- **Firm's muni chief Hayes sees demand holding up into 2020**

Here's one reason why BlackRock Inc., the world's largest money manager, doesn't expect a pullback from the municipal-bond market next year: Google searches for the securities jumped in April, when many Americans first felt the impact of President Donald Trump's tax-cut law.

The $10,000 cap on state and local tax deductions it ushered in helped set off a record-setting municipal-bond buying spree by those hunting for ways to drive down what they owe. And that interest is unlikely to subside anytime soon, Peter Hayes, head of such investments for BlackRock, said on Tuesday.

"We think that this demand continues at least into the first half of 2020 at its current pace," Hayes said at a media event hosted by the company.

Continue reading.

Bloomberg Markets

By Amanda Albright and Danielle Moran

December 10, 2019, 10:39 AM PST

High Yield Munis Can Be An Equity Hedge, But Understand The Risks.

Summary

- Many investors are looking for ways to hedge against a potential decline in equities, after an impressive run in 2019.
- Municipal bonds are one of my preferred choices for fixed-income exposure, as they have historically low levels of defaults and a low correlation to the equity market.
- High yield munis, however, are less attractive right now. Their spread with investment-grade munis has shrunk, and some bonds in the high-yield sector are struggling to manage debt obligations.

Main Thesis

The purpose of this article is to evaluate the VanEck Vectors High-Yield Municipal Index ETF (HYD) as an investment option at its current market price. As my readers are aware, I have recommended municipal ((muni)) debt in 2019, and that play has been rewarded. However, I have taken a more cautious tone as, similar to equities, valuations have gotten a bit rich and my outlook is less optimistic than when the year started. On that note, I am on the hunt for funds trading at reasonable valuations and which utilize less leverage, which has brought me to HYD, as it is a high-yield muni fund that does not utilize any leverage. While the fund has returned close to 10% this year, and I remain bullish on muni debt, there are a few reasons why I would hesitate to recommend this option. The strength of the high-yield muni sector largely depends on revenue bonds, which offer unique risks to investors that general obligation bonds do not. While this is not necessarily "bad", it is a sector that has been under some short-term pressure. Further, spreads between high-yield munis and investment-grade munis has narrowed recently, suggesting a limited chance of further outperformance from here. Finally, while high-yield munis do offer an attractive way to hedge against downside in the equity market, investment-grade munis offer a similar opportunity.

Continue reading.

Seeking Alpha

Dec. 15, 2019

A New Look at How States Block Local Laws in Areas Ranging From Guns to

Taxes.

“This is a national preemption movement that is occurring,” says the CEO of the National League of Cities.

States around the U.S. have all sorts of laws on the books to block, or “preempt,” cities, towns and villages from enacting their own local policies on issues like the minimum wage, gun safety, rent control, plastic bag restrictions, and taxation.

This big-footing by state governments creates obstacles for communities seeking to tailor their own laws in these and other areas and is a source of frustration for many local elected leaders. It’s also becoming increasingly common, with an uptick in the past five years or so, said Clarence Anthony, CEO of the National League of Cities.

“This is a national preemption movement that is occurring,” Anthony told Route Fifty on Thursday. “We’re seeing that it’s unprecedented.”

“Local control is under attack,” he added.

It’s against this backdrop that the National League of Cities recently partnered with Temple University on a project to analyze preemption in 12 different policy areas, in all 50 states.

This project culminated in an online tool, where it’s possible to select a state from a map of the U.S. and to then see details about how state laws preempt local ones in each place.

There’s a significant amount of detail for each state and policy area.

For example, the tool shows not only whether a state preempts local gun laws, but also which kinds of regulations are explicitly prohibited (such as those dealing with possession, sales, and concealed carry), and penalties officials can face for trying to regulate in these areas.

NLC says that some of the areas where preemption is the most common include gun laws, rent control and tax policy. The League also notes that there are at least nine states that lack mandatory paid sick leave, while also blocking local laws in this area.

Some of the other areas the project provides information for include: “ban-the-box” policies that restrict employers from asking about a person’s criminal history on job applications, property zoning, municipal broadband, and an array of tax limitations.

Spencer Wagner, a program specialist at NLC who worked on the project, identified two key factors he said are driving the rise in preemption that Anthony mentioned.

One, he said, is that businesses are spending more money to prevent what they often describe as a “patchwork” of local laws.

“We don’t really accept that argument,” Wagner said. “Every day businesses are working in different communities with different tax codes and health regulations.”

Another factor, he said, is the emergence of more “model legislation” from groups like the American Legislative Exchange Council, which can provide state lawmakers with ready templates for introducing bills that stymie local lawmaking.

Anthony flagged Arizona and his home state of Florida, where he served as mayor of South Bay for

24 years, as two states that have been especially aggressive on the preemption front.

"If someone comes into my home, I don't expect they're going to go there and tell me what kind of music I can play," he said. "That's in a sense how I feel about it. It's the lack of respect that our local leaders are getting in terms of the policies that they need for their cities."

ROUTE FIFTY

by BILL LUCIA

DECEMBER 12, 2019

Muni-Bond Ratings Are All Over the Place. Here's Why.

Amid fight for market share, ratings companies struggle to judge creditworthiness of financially troubled cities

Chicago is in bad financial shape, with an unsustainable pension burden and a towering debt load. Yet the city will shortly issue bonds that are likely to be rated as supersafe, even though similar investments have lost money.

Bond-ratings firms are struggling to judge the creditworthiness of cities and local governments with deep financial problems. There have been widely disparate ratings, errors in analysis and a fight for market share that may have produced optimistic outlooks.

Chicago has the most pension debt of any major U.S. city, according to Merritt Research Services, and a shrinking population. To help cover an $838 million budget shortfall, the city is planning to sell up to $1.5 billion in bonds beginning as soon as this month.

Continue reading.

The Wall Street Journal

By Gunjan Banerji

Dec. 6, 2019 5:30 am ET

Fitch Exposure Draft for U.S. Affordable Housing Rating Criteria & Webinar

Fitch's proposed criteria focus on bonds secured by less than 10 cross-collateralized: federally subsidized multifamily affordable housing properties; solely unsubsidized multifamily affordable housing properties; or properties with a combination of subsidized and unsubsidized affordable housing units.

Read the Exposure Draft.

Related Webinar:

U.S. Affordable Housing Criteria Exposure Draft | December 12, 2019 at 2:PM EST

An Ominous Signal in the Muni-Bond Market Now Seen as Just Noise.

- **Governments may start selling debt faster than it's paid off**
- **Barclays sees positive net supply of $80 billion in 2020**

An ominous signal in the municipal-bond market shouldn't scare buyers too much.

State and local governments' frenzy to seize on lower interest rates could leave them issuing new bonds next year at a faster pace than they're paying them off, causing an increase in the net supply of outstanding securities. Usually, that's viewed as a negative in the $3.8 trillion municipal market, given that the increase in supply can exert a drag on prices.

But this time, the jump may be matched by a flood of cash that's been washing into the market all year as Americans burned by the limit on state and local tax deductions use the investments to drive down what they owe to the federal government. Municipal-bond mutual funds last week alone received a record $2.36 billion of new cash, according to Refinitiv Lipper US Fund Flows data, extending an unprecedented influx that's continued since January.

"Higher net supply is not going to be oversupply," said Peter Block, head of municipal strategy at Ramirez & Co., which is projecting positive net supply of $98 billion next year.

The increase follows what had been a slowdown in new municipal-bond sales, which caused the size of the market to shrink in 2018 and during the first half of this year, according to Federal Reserve figures. That led mutual fund managers to complain about the competition and high prices being paid for new debt issues, though the drop in yields also saved state and local governments money.

With the market's interest rates now holding not far from more than half-century lows, Wall Street underwriters anticipate the pace of borrowing to pick up. Barclays Plc is forecasting that will cause the size of the market to grow by $80 billion in 2020, which the company projects would be the biggest increase since 2016. Bank of America Corp. strategists last month predicted a similar rise.

The ballooning supply is driven heavily by state and local governments' push to refinance their debt with taxable securities. While that may be a drag on that corner of the market, analysts say it's unlikely to trickle into demand for traditional tax-exempt bonds, which will also benefit from interest and principal payments that bondholders will seek to reinvest.

Barclays strategists led by Mikhail Foux said their forecast for positive net supply in 2020 won't be problematic for tax-free buyers because those sales won't increase "materially."

Bloomberg Markets

By Amanda Albright

December 3, 2019, 10:50 AM PST

[“Small Claims Court” Lawsuits Could Cost Wall Street’s Credit Rating Agencies Billions.]

This is truly a story about David verses Goliath. Over the past four to five months, two hundred and forty small claims court lawsuits have been filed with the California Superior Court. The plaintiffs claim that the executives at the three largest credit rating agencies, Moody’s, Fitch and S&P engaged in securities fraud, mail fraud, wire fraud, bribery, extortion and racketeering when they issued credit ratings on tens of billions of dollars in Puerto Rico municipal bonds. The plaintiffs are seeking to recover two thousand five hundred dollars.

Unbelievably, the credit rating agencies decided to dispute the claims rather than reach a settlement. I say “unbelievably” because of what you are about to read next.

The credit rating agencies dispute resulted in an evidentiary hearing on November 15, 2019. The defendants claimed the court did not have jurisdiction in these cases. The court denied that motion and reaffirmed jurisdiction over these disputes. The defendants claimed one of the plaintiffs did not have legal standing to participate in a lawsuit. That motion was also denied by the court. The court asked the plaintiffs to submit evidence justifying these lawsuits.

The following was submitted to the court: A copy of a forensic accounting audit on the bonds reflecting the fact that the municipal agencies were already bankrupt prior to the issuance of these bonds. Sworn testimony from municipal executives claiming that the credit rating agencies knew them to be bankrupt but would issue good credit ratings in exchange for hefty fees. Sworn testimony that the lead auditor for the municipal agencies stating the agencies have been technically bankrupt since 2010. Documents confirming the existence of recorded telephone conversations reflecting payoffs to Department of Justice personnel to prevent any investigations or prosecutions.

The court determined that sufficient evidence exists to move forward with these small claim cases. The evidence was shared with the Riverside District Attorney, Michael Hestrin who then forwarded the evidence on to the California, Attorney General, Xavier Becerra.

One has to ask? What were the credit rating agency executives thinking? Now they are looking at the possibility of billion of dollars in fines from the Securities and Exchange Commission and the real possibility of criminal charges.

The plaintiffs have recently requested that the court issue subpoenas forcing the appearance of the defendants in these small claims court hearings. There is no doubt that there will be law enforcement personnel in the courtroom eagerly listening to the defendant’s testimony. Stay tuned this story can only get better. Honestly, you can’t make this stuff up!

ROCKLAND COUNTY TIMES

BY RICHARD LAWLESS

December 5, 20190 Comments

Richard Lawless is an investigative journalist and one of the plaintiffs involved in these 240 lawsuits. Lawless has written articles on financial fraud that have appeared with major media outlets all over the world. He has 30 years of experience as a senior and executive banker for companies like Wells Fargo Bank and Home Savings and has served on a number of corporate boards.

S&P: U.S. Higher Education Is Learning To Manage Its Own Risk

How Event Risk That Creates A Crisis Can Have An Impact

Colleges and universities are grappling with event risk with increasing frequency, whether from nature (think weather) or man-made (such as campus shootings, management and governance controversies, racial tensions, or sexual assault). These crisis incidents create difficult assessments in terms of their impact on credit quality, with some not resulting in an immediate rating action and many not triggering any credit action at all owing to some combination of factors that can substantially mitigate the associated risks. In our opinion, these factors include a sound enterprise risk management (ERM) program that is in place and followed promptly; strong management and governance controls; ample financial resources, which may include insurance coverage for the specific risk; and the ready availability of and access to external support such as disaster aid programs. Additionally, we have seen schools with strong market positions that benefit from national brand recognition and solid demand experience little, if any, impact to enrollment or fundraising.

Recent high-profile events of the man-made variety include the Department of Justice's investigation into higher education admission practices ("Varsity Blues," the codename for this examination) and the Harvard admissions lawsuit, which have received widespread news coverage, attracting significant negative attention to the higher education industry. These proceedings have placed a focus on the adequacy and transparency of management and governance and the importance of sound internal controls, such as the need for a well-developed ERM program that can contribute toward an effective response strategy.

While most crisis events represent a significant operational challenge and potentially an immediate headline risk, testing an institution's tactical responsiveness, the long-term effect on a college or university's creditworthiness often takes several months to manifest. Consequently, it is not the actual event but the institution's ability to respond and adapt in light of it that determines whether there will be any credit implications. In most cases, swift corrective actions and effective outreach have enabled institutions to maintain their ratings. On the other hand, some risk management or governance failures have resulted in negative rating actions.

Continue reading.

S&P: U.S. States Are Slow To Reform OPEBs As Decline In Liabilities Masks Increased Risk

Table of Contents

U.S. states continue to severely underfund their other postemployment benefit (OPEB) plans. S&P

Global Ratings' latest survey found that for most states, annual plan contributions do not keep up with growth in liabilities. Given the degree of underfunding, unfunded OPEB liabilities will likely escalate absent meaningful reform.

However, most states have not recently pursued reform efforts. Because the size of these unfunded liabilities varies greatly among states, progress toward reducing them is more pressing for some than others. S&P Global Ratings believes it crucial for states to prudently manage plan fiscal health ahead of a tipping point where rising OPEB costs lead to budgetary stress.

Despite contributions that generally fall short of growth in liabilities, S&P Global Ratings' most recent survey data also indicates that total net OPEB liabilities for states fell by 7.3% in fiscal 2018. This drop occurred primarily due to an increase in the discount rate used to measure OPEB liabilities rather than improved funding or OPEB reforms. Generally, state plans have applied a discount rate based on a municipal bond rate due to a general lack of interest earning assets and Governmental Accounting Standards Board (GASB) methodology.

Continue reading.

Historic US Towns Endured Wars, Storms. What About Sea Rise?

SWANSBORO, N.C. — Historic cities and towns along the Southeastern U.S. coast have survived wars, hurricanes, disease outbreaks and other calamities, but now that sea levels are creeping up with no sign of stopping, they face a more existential crisis.

With a total annual budget of $225 million, Charleston, South Carolina, can't afford the billions of dollars to save itself without federal help. It's counting on the U.S. Army Corps of Engineers to help surround its downtown peninsula with seawalls, harkening to the barriers the city built when it was founded 350 years ago.

Keeping water off the streets and buildings is even more difficult for smaller towns like Swansboro, North Carolina, with 3,200 people and a $4 million budget that doesn't account for climate-related sea rise.

The most vulnerable coastal communities sit only a few feet above sea level and are already getting wet at some high tides. Scientists estimate the sea will rise another 2 feet (61 centimeters) to 4 feet (122 centimeters) in the next 50 years.

Municipal leaders say they need billions of state and federal dollars to save block after city block of low-lying homes and businesses. And while even climate change-denying politicians are beginning to acknowledge the inevitable onslaught, city officials worry that those who control the purse strings won't see the urgency of a slowly unfolding catastrophe that's not like a tornado or earthquake.

Founded in 1783, Swansboro became the center of North Carolina's steamboat industry. In 1862, it saw Union troops burn down a Confederate fort guarding the nearby Bouge Inlet to the Atlantic Ocean. Across its quaint downtown on the White Oak River, almost every building boasts a city seal with the date it was built. Most are much older than the gray-haired tourists strolling around, and can't forever withstand the kind of flooding they suffered last year, when Hurricane Florence's sea surge topped 30 inches (76 centimeters) of rain.

Stunned, the town commissioned a report for the future. It said the water's edge may end up a block or two inland from the historic waterfront, and soberly suggested: “Consider retracting services or strategically abandoning infrastructure in areas that are likely to be risky or dangerous.”

Local leaders recognize the importance of Swansboro’s charm, but its future is largely out of their hands.

“We’re going to be very, very dependent on outside funding,” new Town Manager Chris Seaberg said. “We’re trying to preserve the history, but trying to accommodate these new issues that weren’t there 100, 200 years ago.”

North Carolina passed a law in 2012 preventing the state from forming coastal polices based on sea rise predictions. But Republican control of the legislature is waning, and local leaders say hurricanes Matthew in 2016, Florence in 2018 and Dorian in 2019 — along with changing attitudes toward climate science— appear to be shifting the state’s outlook. North Carolina created an Office of Recovery and Resiliency this year to plan for floods and other extreme weather events.

“There will need to be political stressors to get people to understand the importance of climate change,” said Beaufort, North Carolina, Mayor Rett Newton.

An Air Force retiree who is getting his PhD in marine science, Newton sweeps his arm across the Beaufort Channel. One spot is where the pirate Blackbeard scuttled some of his ships 300 years ago. Nearby is where blockade runners hid from British ships while helping supply the U.S. in the War of 1812. And on the horizon is where freed slaves helped Union troops defeat Confederates in 1862.

The historic buildings along Beaufort’s waterfront are gleaming now, reflecting millions in new investment. It wasn’t like that when Newton grew up in the 1960s amid grimy seafood shops, rundown shacks and fish plants. People wealthy enough to buy waterfront property can always move, Newton said, but escaping the seas will be much harder for poorer residents, who often live on low-lying land handed down through generations, are already beset by social and economic problems.

“I can’t tax anyone else. At the local level, we can’t tax our way out of this,” Newton said, noting his town of 4,200 people collects about $3.5 million a year in taxes.

Charleston, with state and federal help, is spending $64 million to raise the lowest part of the seawall guarding its downtown Battery, which should keep that part of the city safe even if the ocean rises more than 6 feet (2 meters) in the next century, Chief Resilience Officer Mark Wilbert said. The city also is spending hundreds of millions of dollars to modernize its storm water system.

But these measures alone probably can’t save a city that was once the most heavily fortified in North America, with a system of walls, moats and drawbridges to keep out the Spanish, French, Native Americans, and occasionally the ocean as well.

The city’s 7 million visitors each year come looking for old charm along the water, but probably not underfoot. Downpours regularly cause flooding these days, and more than once a week on average, Charleston gets “sunny day” flooding when tides push water onto city streets.

Four of the seven highest water levels recorded in Charleston Harbor have happened in the past four years, pushed by Hurricane Matthew in 2016, Hurricane Irma in 2017 and nor’easter type storms that hit in 2015 and 2018.

“What used to only happen occasionally is happening more often,” Wilbert said.

Charleston is working with the Army Corps on solutions, and everyone agrees sea walls aren't the only answer. Also under consideration are flood gates, enhanced pumps and other potential fixes, and the city hopes for plenty of state and federal help to pay for it.

South Carolina highway funds are already going to raise the downtown sea walls, and Republican Gov. Henry McMaster created the South Carolina Floodwater Commission, which is studying freshwater and ocean flooding and exploring the use of artificial reefs to blunt massive waves in hurricanes.

Charleston also plans to seek at least some of the state's tourism taxes on hotel rooms and restaurant meals for flood control. Currently, that money must be spent on tourism.

"You are not going to reverse this. The sea level is going to keep rising," Wilbert said. "It's not something where you can say how much it will cost or when it will end."

By The Associated Press

Dec. 5, 2019

[Elevated Muni Supply to Be Met With Healthy Demand in 2020, BlackRock's Carney Says.]()

Sean Carney, BlackRock Financial's head of municipal strategy, discusses the outlook for municipal bonds in 2020 with Bloomberg's Taylor Riggs on "Bloomberg Markets."

[Watch video.]()

Bloomberg MarketsTV Shows

December 4th, 2019, 8:38 AM PST

[Historic U.S. Towns Now Face A Rising Sea.]()

SWANSBORO, N.C. — Historic cities and towns along the Southeastern U.S. coast have survived wars, hurricanes, disease outbreaks and other calamities, but now that sea levels are creeping up with no sign of stopping, they face a more existential crisis.

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"What used to only happen occasionally is happening more often," Wilbert said.

Charleston is working with the Army Corps on solutions, and everyone agrees sea walls aren't the only answer. Also under consideration are flood gates, enhanced pumps and other potential fixes, and the city hopes for plenty of state and federal help to pay for it.

South Carolina highway funds are already going to raise the downtown sea walls, and Republican Gov. Henry McMaster created the South Carolina Floodwater Commission, which is studying freshwater and ocean flooding and exploring the use of artificial reefs to blunt massive waves in hurricanes.

Charleston also plans to seek at least some of the state's tourism taxes on hotel rooms and restaurant meals for flood control. Currently, that money must be spent on tourism.

"You are not going to reverse this. The sea level is going to keep rising," Wilbert said. "It's not something where you can say how much it will cost or when it will end."

The Associated Press

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The Bond Is in the Mail: Muni Market's New Way Around Trump Ban.

- **So-called forward delivery bonds used to lock in low rates**
- **It's one way to refinance after 2017 law yanked subsidies**

Anyone who agreed to buy the bonds sold by Washington state this month has a long wait until they see a return on their investment: the nearly $400 million of securities won't be delivered until March 2021.

The delay is the result of an increasingly popular maneuver that states and cities are using to get around a provision of President Donald Trump's 2017 tax-cut law, which stripped them of their ability to sell tax-exempt bonds to refinance debt that can't yet be called back from investors.

But with rates hovering near more than half-century lows, local governments are eager to refinance. So they're selling bonds now that investors won't receive until months — or even years — later when the outstanding securities can be bought back. There have been $10 billion of such municipal bonds sold this year, the most since at least 2005, with $1.4 billion in the last month alone, according to data compiled by Bloomberg.

Illinois's Metropolitan Pier and Exposition Authority is planning next week to sell $923 million in bonds that won't be delivered to investors until March 2020. Washington D.C.'s airport authority is selling $364 million in bonds Dec. 12. Those won't settle until July.

"The interest rates are just so favorable right now," said Larita Clark, chief financial officer of the Metropolitan Pier and Exposition Authority, which expects to save as much as $150 million. "We just wanted to lock in those rates."

After the Federal Reserve cut rates for a third time this year, Henry Dachowitz, the chief financial officer for Norwalk, Connecticut, decided to sell about $18 million of forward delivery bonds. He had been talking to multiple underwriters who were marketing the structure.

"The forward structure was new to me. I explored it and when I saw the present value savings were almost $2 million, it was compelling," he said in an interview. "I thought interest rates if anything would go up. It was time to pull the trigger after the last rate cut."

Washington delayed the delivery date longer than any other borrower this year, according to data compiled by Bloomberg. The nearly year-and-a-half wait did come with a price: the 10-year bonds were priced with a 2.3% yield, or 73 basis points more than top rated debt. Comparatively, the state in September sold 10-year bonds for 1.47%, a 16 basis-point spread.

Sylvia Yeh, co-head of municipal fixed income at Goldman Sachs Group Inc., said the deals are largely suited to bigger institutional investors, given the risks that could crop up between when the bonds are sold and when they're delivered.

"The funds definitely have the opportunity to do this. For them it comes down to spread," she said. "There is appetite at a price. That speaks to how our market continues to develop."

Bloomberg Markets

By Danielle Moran and Fola Akinnibi

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— With assistance by Sowjana Sivaloganathan

A Missouri Bank is Using Tech to Secure Large Deposits from Public Entities.

Bank of Franklin County, a Washington, Mo.-based bank with $273 million in assets, is using 'cash sweep' technology to gain large deposits from public funds without having to put up its own assets as collateral.

While accepting large deposits is not a pain point for most financial institutions, accepting public funds requires additional steps. If a bank accepts a deposit over the FDIC insurance limit ($250,000) from a public entity, banks have to put up their own assets as collateral, limiting their abilities to use these funds for other purposes.

Becky Buhr, vice president of finance and retail manager at Bank of Franklin County, told Bank Innovation the bank has sought help from the tech company Reich & Tang to seek an alternate solution to this problem that involves spreading out the deposit among a network of institutions.

“All these banks that participate in the [Reich & Tang] network each have $250,000 of FDIC insurance coverage, so they can take my $13 million, put it out there on that network and it gets spread out among all these banks in increments of less than $250,000,” Buhr said.

According to Bank of Franklin County, this tool has been used since May of this year, when the bank secured a $13 million deposit from the local school district. “The school district gets full FDIC insurance. They get a good interest rate. I get $13 million that I have access to any time,” Buhr explained.

The deposit came from the School District of Washington, which wanted to work with a local bank that could reinvest that money in the community. When Bank of Franklin County was deciding whether or not to bid on the deposit, Buhr said she needed to find a way to secure it without having to offer up the bank’s assets as insurance. Reich & Tang, which has hundreds of banks on its deposit marketplace, told Buhr it could spread those funds throughout its member institutions and provide the required FDIC insurance.

The bank can access the funds by emailing Reich & Tang, which will then wire the money to the bank, explained Buhr. Institutions on the marketplace can also request capital to fund new loans, but they must pay Reich & Tang back with interest.

The technology acts as a two-way street for capital solutions. Banks that need money can request it, and banks that need to insure their deposits can send money. Bank of Franklin County, according to Buhr, actually generates revenue from interest Reich & Tang pays to keep the deposit on its marketplace.

The Bank of Franklin County has five branches in eastern Missouri, slightly west of St. Louis. Although its primary functions are commercial transactions, it also features retail products like personal checking and savings accounts. According to Buhr, the cash sweep technology is part of a bigger effort to digitize operations.

“We have a very robust online banking platform, and we have a very robust mobile banking platform. We offer remote deposit capture so our business customers can scan in their checks right on site,” Buhr said. “We really can compete with the big banks, but what limits us is the size of those relationships.”

Bank Innovation

by Rick Morgan

December 2, 2019
