Bond Case Briefs

Municipal Finance Law Since 1971

Debt-Ceiling Alarm Freezes Market With Least Supply: Muni Credit.

Municipalities are borrowing at the slowest pace in more than two years, showing how the partial federal shutdown and prospect of a U.S. default are dissuading localities from taking on financing for new projects.

Cities and states are offering $4.3 billion of bonds this week after $3.7 billion last week, when the U.S. government shutdown began, data compiled by Bloomberg show. Excluding holidays, it's the skimpiest stretch of financing since May 2011, even as benchmark muni-bond yields have fallen from a two-year high.

Enlarge image

San Francisco and a school district in Utah are among issuers that may shift sales scheduled for Oct. 17, the day U.S. borrowing authority lapses. Photographer: David Paul Morris/Bloomberg

As the political stalemate persists, supply may dwindle further. San Francisco and a school district in Utah are among issuers that may shift sales scheduled for Oct. 17, the day U.S. borrowing authority lapses. The ebbing tide of new bonds is echoed in diminished trading: Volatility on benchmark 10-year muni yields has dropped close to a 10-month low.

"Without new issues to give a little bit of price discovery, offers are drying up, bids are getting quiet, and when you add in the politics, the shutdown and the debt ceiling, it seems like people are sitting on their hands," said Dan Toboja, vice president of muni trading at Ziegler Capital Markets in Chicago. "I would almost call it complete malaise."

Already Down

The federal gridlock is exacerbating a drop in local financings as interest rates have risen from generational lows seen in December. Cities and states have issued $233 billion of fixed-rate long-term debt through Oct. 4, down 15 percent from the same period last year, data compiled by Bloomberg show.

Municipalities planning their financing amid the standoff in Washington have to consider the potential impact on market interest rates and the economy. The Treasury Department has said any U.S. default from failing to raise the $16.7 trillion federal debt limit could have catastrophic consequences that might last decades.

The Sevier County School District in Utah, with about 4,500 students, has a $36 million bond sale set for Oct. 17. Proceeds from the competitive deal will go toward building a high school. Patrick Wilson, the district's business administrator, said he has talked with his financial adviser about possibly changing the date.

"I have a little bit of concern" about selling the day of the debt-ceiling deadline, he said in an interview. “The market could be pretty wild.”

Volatility Vanquished

The federal government’s first partial shutdown in 17 years began Oct. 1, halting a rebound in the municipal market fueled by the Federal Reserve’s surprise decision in September to maintain the pace of its monthly bond buying.

Ten-year benchmark muni yields have barely budged over the past two weeks, fluctuating just 0.02 percentage point, Bloomberg data show. Volatility has tumbled, deadening the market swings that generate trading opportunities. For 10-year yields, 60-day volatility is close to the lowest since December, data compiled by Bloomberg show.

A stable muni market is uncommon in October. Benchmark 10-year muni yields have jumped about 0.24 percentage point on average in the month since 2009, Bloomberg data show.

“The market is quiet right now, and that’s pretty rare, especially in October,” Toboja said.

Investing Antipathy

The federal government shutdown has slowed other fixed-income markets too. Corporate bond sales in the U.S. have dropped to $15.2 billion this month from $48.1 billion in the year-earlier period, according to Bloomberg data.

“Underwriters are very hesitant to advise issuers to come to market during somewhat unsettled times,” said Bart Mosley, co-president of Trident Municipal Research in New York. The shutdown and debt-ceiling debate are “keeping investors from feeling like they have to take action, which has led to subdued activity.”

San Francisco plans to sell about $37 million of tax-exempt bonds in a competitive deal Oct. 17 to pay for work at ports, including a cruise-ship terminal, and refinance commercial paper issued to move the project along.

The city has until 1 p.m. local time the day before the sale to postpone, said Nadia Sesay, director of the city controller’s office of public finance.

As Advertised

“We have advertised for a sale on the 17th and we’re hoping we can keep it, but we’re going to continue to monitor the market and see what’s happening with the debt ceiling,” Sesay said in an interview.

Cicero, an Indiana town of about 4,800 residents, has a $2.4 million sewer-revenue bond deal set for Oct. 17. Deen Rogers at H.J. Umbaugh & Associates, the town’s financial adviser, said officials have flexibility to shift the sale if necessary because of the debt-ceiling debate.

Stephen DeGroat, finance commissioner of Rockland County north of New York, said he’s concerned that its $34 million general-obligation issue is scheduled for Oct. 17. He said he plans to call the county’s financial advisers and is open to moving the date.

In 2011, Republicans and Democrats reached a deal to raise the borrowing limit ahead of an Aug. 2 deadline and avoid default. Similar to this month’s reduced volatility, 10-year benchmark muni yields were unchanged that year from the end of June to the end of July, Bloomberg data show.

Offsetting Interests

“Sellers are saying maybe the market will tighten up if we pass the debt ceiling,” Toboja said. “Buyers are saying if we get any kind of supply, the market is going to cheapen up. The end result is you’ve got nobody doing anything.”

Deals in the municipal market this week include a $563 million general-obligation sale from Wisconsin.

The state is issuing with top-rated 10-year munis yielding 2.72 percent, close to the lowest since June. The interest rate compares with 2.66 percent for similar-maturity Treasuries.

The ratio of the yields, a gauge of relative value, is about 102 percent, compared with an average of 93 percent since 2001. The higher the figure, the cheaper munis are compared with federal securities.