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Muni Market Shrinks; Bank Muni Holdings Rise.

WASHINGTON — The total amount of outstanding municipal securities in the market fell almost 1.2% to \$3.67 trillion last year from 2012, while munis held by banks jumped 14.68% to \$416.4 billion over the same period, according to the Federal Reserve's latest Flow of Funds report released Thursday.

The drop in outstanding munis "is consistent with the trend over the last several years" and shows that new money issues are not keeping up with refundings and redemptions, said Michael Decker, managing director and co-head of munis at the Securities Industry and Financial Markets Association.

But while the level of outstanding munis for 2013 has fallen to about what it was in 2009, banks have almost doubled their muni holdings over that same period. They held only \$224.3 billion of munis in 2009.

"That's a very notable trend," said Decker. "Banks are much more relevant to the muni market. They are buying new issues to a much larger degree. They're really filling the gap for short-term and variable rate products that is left from the shrinking variable rate demand obligation market and auction-rate securities market, what's left of it."

The financial crisis basically killed the ARS market and made VRDOs less attractive because of higher costs and the risks associated with renewing liquidity facilities and the possibility the liquidity provider could be downgraded. Costs have come down. But short-term floating rate notes provide the same benefits but are less complex. Issuers have been selling them and banks have been buying.

Banks also "have a lot of cash and they're looking for investment opportunities," Decker said. "Their cost of funding is very, very low, which means the tax hit associated with buying munis is low."

Decker said he sees banks continuing to increase their muni holdings in the near-term.

The outstanding munis of state and local governments and nonprofit organizations were down, 1.3% and 5.5%, respectively, this year from last. But the outstanding munis of nonfinancial corporate businesses were up 1.85% to \$518.5 billion this year, according to the report.

Retail investor and other household sector holdings of munis fell to \$1.62 trillion last year from \$1.65 trillion in 2012. The household sector is a catch-all category that mostly made up of retail investors but also includes some domestic hedge funds, private equity funds and personal trusts, a Federal Reserve spokesman said.

Property-casualty insurance company muni holdings rose 1.43% to \$332.3 billion last year from 2012 while life insurance company holdings of munis increased 2.82% to \$135.1 billion.

Money market fund holdings of munis fell 8.4% to \$308.3 billion at the end of the year from the previous year, while mutual fund holdings were down 2.6% of munis to \$610.9 billion. The outflows

were mostly driven by sustained low yields and investors looking for yield elsewhere, although it is possible that the financial and bond-related problems of Detroit and Puerto Rico could have had some small effect, Decker said.

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