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Washington Bonds Beat Market as Federal Cuts Defied.

Even a budget-cutting Congress isn't hurting Washington's standing on Wall Street.

Debt of the nation's capital has returned 9.1 percent this year, beating 45 states and the 7.8 percent advance for the broader $3.7 trillion municipal market, according to Barclays Plc data. The city plans to sell $523 million of general-obligation bonds this week, its largest offering since last year's federal spending reductions began exerting a drag on the local economy.

The District of Columbia comes to market with its highest credit score yet after Fitch Ratings and Standard & Poor's raised its grades last month. Even though about one in four jobs are tied to the federal bureaucracy, industries such as health care and education are adding workers more quickly than the government is retrenching. At the same time, the municipality's savings have swelled.

"Even with the slowdown in the federal government, Washington has outperformed other cities" since the recession, said Paul Mansour, head of municipal research in Hartford, Connecticut, for Conning & Co., which oversees about $11 billion in local-government debt. "A lot of people view the District of Columbia's bonds as a cut above other city debt."

'High Quality'

Washington joins borrowers tapping demand for tax-exempt securities with the municipal market on pace to shrink for a fourth straight year. With less debt available, buyers have boosted prices on even the riskiest securities, and 30-year benchmark bonds yield 3.1 percent, close to the lowest since May 2013, data compiled by Bloomberg show.

"The municipal market is extremely expensive," said Josh Gonze, a money manager in Santa Fe, New Mexico, at Thornburg Investment Management, which holds about $10 billion in munis. "There's a high degree of interest in buying tax-exempt bonds and not a lot of supply. Even low-quality bonds aren't having trouble being placed. So a high-quality issue like one out of Washington won't have any trouble."

The sale, set to conclude Oct. 8, is the district's largest since November 2012, when it issued $751 million of bonds backed by income-tax revenue, Bloomberg data show.

School Projects

While borrowers including Pennsylvania and Chicago have had bond grades cut as they wrestle with fiscal strains such as rising pension costs, Washington's standing has improved.

In 2013, its pension for police and fire personnel had more money than needed to pay for promised benefits, while its teachers' plan was 90 percent funded, bond documents show.

On Sept. 29, Fitch and S&P raised Washington to AA, the third-highest rank, citing financial strength in the face of the pullback in federal spending.

Mayor Vincent Gray, a Democrat, said the upgrades give the city its highest ratings ever, and may save taxpayers millions in financing costs.

Treasurer Jeffrey Barnette said the bonds, more than a third of which mature in 2038, will refinance debt and pay for construction projects, including work on schools. The district may benefit from the rating boost and investor appetite for munis, he said.

“There’s just been demand across the curve, whether it’s long- or short-term,” he said in a telephone interview. “Any time you get better ratings there should be a better perception from the investment community.”

District bonds have earned 2.3 percent in the past three months, compared with 2.1 percent for the entire market, Barclays data show.

Federal Buoy

Washington general obligations maturing in June 2024 have traded in October at an average yield of about 2.3 percent, Bloomberg data show. That’s about 0.30 percentage point above benchmark debt, compared with an average yield spread of about 0.4 percentage point since April.

The district emerged from the recession that ended in 2009 better off than other cities, buoyed by government spending. By the end of last budget year, it had a surplus of $321 million. That boosted its rainy-day fund to $1.75 billion, equal to about a quarter of annual revenue.

The city has handled its finances well enough to contend with federal cuts, said Eric Kim, a Fitch analyst in New York.

“While the economy has slowed down a bit, there is still growth there because of the resilience of the private sector,” Kim said. “From a fiscal perspective, they have managed things very well. There’s a real sense of fiscal discipline.”

Sequestration Blow

The pressure to curb federal spending has had an impact. When cuts known as sequestration were put in place, the city’s economy, adjusted for inflation, shrank 0.5 percent in 2013, according to the Census Bureau.

The Obama administration began implementing automatic spending cuts across government programs last year as a result of an agreement with Congressional Republicans to reduce the federal budget deficit.

In 2014, revenue has grown 1.2 percent, trailing the district’s 2.1 percent projection in part because of federal tax-law changes that caused forecasts to be overly optimistic.

Other indicators point to brighter prospects. The population swelled to 646,000 as of July 2013, up 41,000 from three years before, according to Census data. While the city lost 4,100 federal jobs in the year through July 2014, total payrolls still grew by 8,700 as employers in education, health-care and private business hired at a faster pace, city figures show. The median price of single-family homes and condos has also risen.

Even if tax revenue trails expectations, D.C. may still add to its surplus as a result of reductions elsewhere, said Hilary Sutton, an analyst in New York at S&P. A growing private economy buffers against financial pressures rippling down from the federal level, Sutton said.

“The sequester is a longer-term issue,” Sutton said. “Given the strength of management, they will be able to manage through any revenue difficulties.”

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