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Cash-Flow Crunch Wanes as Note Sales Set Record Low: Muni Credit.

U.S. states and localities issued the fewest short-term notes in at least a decade in 2014, the latest sign that municipal budgets nationwide are strengthening.

Sales of the securities, which mature in less than 18 months, fell to $40.3 billion last year, the least in Bloomberg data dating back to 2003. Volume is down from a 2010 peak of $78.5 billion and may sink further: Supply will drop 0.7 percent in 2015, according to a Securities Industry and Financial Markets Association survey.

The largest note issuers, Texas and California, whittled their offerings in 2014 to the lowest since before the recession that ended in 2009, even with interest rates close to the lowest since the 1960s. Demand for notes, used to bridge cash shortfalls, is dimming as the National Association of State Budget Officers forecasts revenue growth will probably accelerate in fiscal 2015.

“The immediacy of having to issue debt on the short end has decreased significantly,” said Steven Shachat, who oversees $1.2 billion of munis, including a money-market fund, at Alpine Woods Capital Investors in Purchase, New York. “States and municipalities are really starting to instill some fiscal responsibility.”

Bridge Tool

Municipalities typically sell notes to raise money before tax revenue flows in, or to begin funding projects before selling longer-dated securities. Now there’s less need to go that route. More finance officers are reporting improved fiscal conditions than any time in the 29-year history of a survey conducted by the Washington-based National League of Cities.

The decline in shorter-maturity issuance is part of a borrowing slowdown in an era of local-government austerity. The municipal market contracted for an unprecedented fourth straight year in 2014 as refinancings and maturing bonds exceeded the amount sold, data compiled by Bloomberg show.

While the broad municipal market has outperformed corporate debt in the past year, shorter-dated local securities have trailed. Munis due in one to two years have gained 0.6 percent in the past 12 months, while comparable company obligations have earned 0.8 percent, Bank of America Merrill Lynch data show.

In California, the most-indebted state, long-term sales fell 8.3 percent from 2013, to $42.4 billion last year. The state also borrowed the least since 2006 for cash-flow needs.

California issued $2.8 billion in revenue-anticipation notes in September to pay bills during the slowest period for tax receipts, down from $5.5 billion in 2013 and $10 billion in 2012.

California Reversal

California's credit standing has improved more than any state's since the recession, winning it the highest Moody's Investors Service rank in 13 years. Governor Jerry Brown has limited borrowing even as taxes on income and corporate earnings have eclipsed estimates.

"By reversing some of the more egregious cash strategies adopted in recent years, the governor improves our ability to weather cash shortfalls in the future," California Controller Betty Yee said in a statement this month. "The governor, legislature and voters deserve much credit for bringing revenues and expenditures into alignment."

Texas is also reducing reliance on short-term debt. The second most-populous state in August offered its smallest note sale since 2007. At $5.4 billion, it was down from $7.2 billion the prior year, though still the largest short-term borrowing nationwide in 2014.

'Budget-Busters'

"Coming out of the Great Recession, states have had to very much live within their means, because there was little cushion for additional expenditures or unexpected growth in programs," said Arturo Perez, a fiscal analyst at the National Conference of State Legislatures in Denver. "There's not much in regards to budget-busters that states are reporting."

Municipalities have mended their finances since fiscal 2010, when states faced a combined $191 billion of budget gaps, according to data from the Henry J. Kaiser Family Foundation. The improvement has helped push interest rates close to zero on notes, with AAA munis maturing in one year yielding 0.22 percent, compared with a five-year average of 0.31 percent, Bloomberg data show.

States and cities may seize on low borrowing costs to issue longer-dated debt in 2015, while cutting back on note sales. Short-term offerings will probably fall to $42.5 billion this year from $42.8 billion in 2014, although total supply will climb 2.7 percent to $357.5 billion, according to a Sifma survey last month.

"Issuing debt in the very short end of the market means issuing at almost zero — that's somewhat of a hard opportunity to pass up," said Shachat at Alpine Woods. "It really is an ideal time to be issuing debt to finance any type of infrastructure needs."

Bloomberg Muni Credit

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