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Suspension of a Treasury Facility Seen Slowing Municipal Refunding.

(Reuters) - The U.S. Treasury confirmed on Friday that it had indefinitely shuttered a key facility used to refinance debt in the \$3.7 trillion municipal bond market in a move set to slow a surge of new bond issuance that has inundated the market this year.

The suspension of the issuance of State and Local Government Series (SLGS) securities, known as the "slugs window", as of noon on Friday was ordered by the Treasury as a temporary extension to the U.S. government's borrowing limit expires on Sunday with little sign Congress will act to extend it promptly.

"Protecting the full faith and credit of the United States is the responsibility of Congress," Treasury Secretary Jacob Lew said in a letter to the legislature on Friday, informing it of the suspension and other extraordinary measures.

Issuing Treasury slugs counts against the debt limit.

Closure of a facility used by municipal governments in debt refinancing transactions is likely to slow refunding operations that have contributed the bulk of new municipal bonds issuance so far this year, analysts say.

"Suspension of slugs sales could disrupt advance refunding activity as the only main alternative is acquiring open-market Treasuries through a competitive bidding process," Oppenheimer said in a research note this week.

Municipal governments purchase slugs in advanced refinancing deals when the bonds they are refinancing are not immediately callable. The municipality puts the slugs in an escrow account and the cash flow is used to repay the debt.

Municipalities prefer to use slugs for advanced refinancing deals rather than Treasuries purchased in the open market because the Treasury tailors coupons and terms of slugs to match the refinanced debt.

Municipal bond issuance has been surprisingly strong so far this year. Refinancing deals have made up the bulk of the deals. New issuance totaled \$58.8 billion in the first two months of the year, nearly double the same period last year.

Of that total, refunding deals amounted to \$39.8 billion, or over two thirds of the total muni bond issuance, according to data compiled by Thomson Reuters.

"Suspending slug purchases will slow that, limiting debt service savings opportunities for state and local budgets," Moody's Investors Service wrote in a report.

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