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JPMorgan Tripling Muni Holdings Signals Banks' Demand Unquenched.

Banks led by JPMorgan Chase & Co. and Wells Fargo & Co. are boosting municipal-debt holdings to a record even as regulators say the securities aren't liquid enough to help during a credit crisis.

U.S. lenders owned $452 billion of munis as of Dec. 31, double their ownership at the end of the recession in June 2009, according to the latest Federal Reserve data. The demand has helped push yields on city and state bonds close to the lowest since the 1960s, reducing financing costs for schools, roads and water systems.

JPMorgan and Wells Fargo have roughly tripled muni holdings since 2009. Banks have reasons to stock up even though regulators decided in September that munis aren't easy to sell quickly in a cash crunch. The bonds offer higher yields than some alternatives, and banks deem them liquid enough to sell down the road as the economy strengthens and lending picks up. Buying municipalities' obligations may also foster business relationships.

"They know which cities they should be worried about and which ones they can be comfortable with," said Marty Mosby, an analyst at Vining Sparks, a broker-dealer in Memphis, Tennessee. "And it provides a liquid asset that they can get in and out of as we have stronger loan demand."

Lobby Effort

Banks own about 13 percent of munis, making them the third-largest holder after households and mutual funds. U.S. lenders added about $33 billion in 2014, helping drive a 9.8 percent gain last year for the securities. It was the best performance since 2011, Bank of America Merrill Lynch data show.

Issuers and analysts have said the liquidity rule, formulated by the Fed, the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency, risks raising borrowing costs in the $3.6 trillion municipal market.

The September measure was among steps regulators introduced to avert a repeat of the 2008 financial crisis. It requires lenders to hold enough assets that are considered high quality – – such as Treasuries and highly rated corporate bonds — to withstand a 30-day squeeze.

JPMorgan, the largest U.S. bank by assets, boosted municipal holdings to $40.6 billion at year-end, up $3.2 billion from a year earlier and almost triple the level in December 2009, bank filings show. Brian Marchiony, a spokesman in New York, declined to comment on the holdings.

Wells Fargo, the most valuable U.S. bank by market capitalization, held about $47 billion as of Dec. 31, more than triple the December 2009 figure.

Ancel Martinez, a spokesman in San Francisco, declined to comment.

Relative Value

Bank of America Corp., the second-biggest lender by assets, increased holdings by $3.6 billion in 2014 to end the year with $9.5 billion, the most since December 2009, bank documents show.

“We don’t comment on our portfolio,” said Jerry Dubrowski, a spokesman in Charlotte, North Carolina.
Banks are buying munis for their relative value, said Alan Schankel, a managing director of fixed-income strategy at Janney Capital Markets in Philadelphia.

Interest rates on 30-year tax-exempt debt have averaged about 0.2 percentage point above Treasuries for the past five years, data compiled by Bloomberg show. Before the recession, investors typically accepted lower yields on munis than Treasuries because of munis’ tax-free interest.

Benchmark munis maturing in three decades yield about 2.9 percent, equivalent to a 4.8 percent taxable yield for top earners. That compares with about 2.55 percent on 30-year Treasuries.

Tax Lift

“A high-quality municipal bond will give them a much better after-tax return than an agency or a Treasury or a high-grade corporate,” Schankel said. “So it’s a compelling argument to include munis.”

U.S. localities can also claim a better track record for repayment than companies. From 1970 to 2013, an average of 0.08 percent of investment-grade munis sold a decade or more earlier defaulted, compared with 2.87 percent for similarly rated company bonds, according to Moody’s Investors Service.

Not all banks are adding. Citigroup Inc. held less than it did at the end of 2009. Mark Costiglio, a spokesman for New York-based Citigroup, declined to comment.

U.S. lenders may curtail buying as consumers’ appetite for borrowing increases, Mosby said.

“If loan demand was to pick up, if it was to get much stronger, then you would see some pullback of the demand that you’ve seen in recent years,” Mosby said.

Purchasing debt from a state or city may also create opportunities to provide banking services, said Joseph Rosenblum, director of muni credit in New York at AllianceBernstein Holding LP, which manages about $32 billion of munis.

“Some of it has to do with enhancing relationships,” Rosenblum said. “So you buy the bond — now you’re the trustee bank, or you’re the depository bank.”

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