

# **Bond Case Briefs**

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## **Despite Bond-Selling Spree, Cities, States Spending Less on Infrastructure.**

An Amtrak train that derailed earlier this month resulting in the death of eight people and the injury of more than 200, sparked a debate on declining infrastructure spending and its devastating effect on American cities and states.

Some claimed that conservative opposition to more funding for Amtrak contributed to the accident, while President Barack Obama pleaded for more infrastructure spending and former New York Mayor Michael Bloomberg condemned Congress for “kicking the can down a pothole-filled road.”

However, the main point was this: construction spending has dropped significantly, relative to the size of the economy, in the last five years.

Yet the municipal bond market—which is where states, cities and all types of local agencies issue bonds to finance their needs—recorded pretty robust bond issuance in 2015.

“We’d have to go back to 2008 to experience an April with as much new municipal issuance as tallied last month,” Alan Schankel, Janney’s head of municipals said in a research note.

Earlier in the year, municipalities went on a bond-selling spree, with new issuance hitting a two-decade high on year-to-date volumes on March 6. That was a 88% increase from the same period in 2014.

So where did the proceeds from all these new muni bonds go? Not to new roads, bridges and tunnels, according to recent data.

In fact, almost 70% of year-to-date muni bond issuance went to refinance existing debt, as opposed to new capital spending, said Jim Grabovac, senior portfolio manager at McDonnell Investment Management.

Or, as Schankel put it, “there is ‘new’ [bonds] as in new to the market and then again there is ‘new’ as in new money for new projects.”

As the chart below indicates, the share of new bond sales that is spent on capital projects has declined by 37.4% over the past 15 years:



The chart tracks the percentage of new muni bonds that are used for capital projects, such as roads, bridges and other public infrastructure—as opposed to refinancing existing debt.

The share of bond proceeds that is actually used for the construction of new projects, or maintenance, has declined over the past four years.

The reason is that cities and states are trying to take advantage of the low-interest rate environment to lower their debt obligations, said Rob Williams, director of income planning for the Schwab Center for Financial Research.

The word on the street is that “if you’re a local government and you can refinance your debt, you’ll do it,” Williams said.

As the window of opportunity is closing, given that a potential interest-rate increase could be approaching, the trend has picked up in 2015.

New muni-bond issuance year to date is currently at \$145.9 billion, 60% above the same 2014 period, according to data from the Securities Industry and Financial Markets Association (Sifma).

But new capital has in fact fallen by 4% compared with last year, whereas year-to-date refinancing volume is currently up 122.7% from the same period in 2014, according to Sifma.

The trend may suggest that U.S. states and municipalities are still in austerity mode. Refinancing muni bonds—just like refinancing mortgages or student loans—is a way to obtain lower interest rates on existing debt, thus reducing the cost of repayment.

This means that municipalities aren’t increasing their debt, but rather paying off their existing loans and substituting it with new bonds with a lower interest rate.

“The aftermath of the 2008 recession is still very sharply in the minds of public administrators,” Williams said.

Unlike the corporate space, where debt is ballooning even as earnings fall, public administrators are in fact hesitant to borrow for new projects and are still in the process of delevering balance sheets.

After the recession, monthly municipal-bond issuances dropped about 68%, according to a Brookings Institution research paper.

In response to the credit crunch, Congress created the Build America Bonds (BABs) program through the “stimulus” bill of 2009, which authorized state and local governments to issue special taxable bonds that received either a direct federal subsidy or a federal tax credit.

The program expired in 2010 and in the past two years, congressional budget sequestration put a damper on the market. In fact, spending cuts reduced the federal BABs subsidy by 8.7% in 2013 and since then, municipalities have been redeeming their BABs to cut costs and to take advantage of historically low interest rates, the Brookings report showed.

In this context, it is no coincidence that net government investment as a share of GDP has been near all-time lows at the beginning of 2015.

## **MARKET WATCH**

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