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Fed Rate Increase Too Late for BlackRock, Alpine Muni Cash Funds.

Whether the Federal Reserve's first interest-rate increase since 2006 comes this week or not, it won't be soon enough for Alpine Funds' municipal money-market fund.

Alpine Woods Capital Investors closed the $120 million fund in April after more than 12 years of operations, joining seven other tax-exempt money-market funds that have liquidated in the last 12 months, according to data compiled by Bloomberg. That number is set to grow. BlackRock Inc. in July said it would close its New Jersey, North Carolina and Virginia money funds by the end of year, leaving it with 15.

"It's tough times in the muni market," said Peter Crane, president of Westborough, Massachusetts-based Crane Data, a money-fund researcher. "Rates are so low that nobody cares about the taxes on them, because there's no income to be taxed."

Caught in a vice of the Fed's zero interest-rate policy and the cost of implementing new government regulations, fund companies are culling their offerings through liquidations and mergers. Municipal money-fund assets have plunged by half since peaking in August 2008, to $250 billion. The falloff has far outpaced taxable money-market funds, which dipped 20 percent in that period, to $2.4 trillion as of Sept. 10, according to the Investment Company Institute.

Municipal funds have been hit harder than prime money funds because the tax-exempt market is dominated by individual investors, while the taxable market is led by institutions which have been holding cash, said Crane. Tax-exempt seven-day money funds currently yield an average of 0.01 percent, while taxable funds yield 0.02 percent, according to iMoney.Net.

"Retail investors have options, whereas institutional investors are dealing with other people's money, so they can't afford to take risks," he said. In particular, assets in brokerage sweep accounts are moving to bank deposits from muni money-market funds, Crane said.

Tax-exempt money-market funds, which invest in high-rated, short-term debt and are treated like cash by investors, may still recover as rates rise. Balances in tax-exempt funds more than doubled from the early 1980s through 2008, with faster inflows when the Fed funds rate was rising than it was declining, according to Moody's Investors Service.

Alpine Woods, based in Purchase, New York, said its fund wasn't big enough to justify additional expenses resulting from U.S. Securities and Exchange Commission rules that take effect in October 2016 aimed at preventing a run on the funds. Costs for lawyers, technology, disclosure and stress testing are going up, fund managers said.

In September 2008, the $62.5 billion Reserve Primary Fund "broke the buck" because of losses on Lehman Brothers Holdings Inc. debt. Its move to reprice shares below $1 sowed panic among investors, who pulled $310 billion from money funds in a single week, helping freeze credit markets.

“Clearly there are some organizations where the cash product is essential to their product line-up and they have the scale to weather the storm,” said Steven Shachat, who managed the Alpine fund. Alpine still has a $980 million “ultra short” municipal fund, whose holdings have an average maturity of about 90 days.

Some bigger fund companies are also trimming product lines. In July, Western Asset Management, a Legg Mason Inc. affiliate, merged its $540 million Institutional AMT Free fund into the $1.3 billion Institutional Tax Free Reserves Fund, citing similar objectives and investment strategies.

“A shift in assets resulting from the low interest rate environment coupled with money market reform, gave us the opportunity to assess our platform and determine how best to continue to meet the investment needs of our clients,” Katherine Ewert, a BlackRock spokeswoman, said in an e-mailed statement.

Money-market fund revenue declined almost 60 percent, to $3.6 billion from December 2009 to December 2014, Crane estimates.

Under the new SEC rules, institutional taxable and municipal money market funds will move from a stable $1 price per-share to a floating share price.

In addition, funds may impose liquidity fees of as much as 2 percent and/or temporary suspensions of redemptions if weekly liquid assets fall below 30 percent. If weekly liquidity falls below 10 percent, money market funds must impose a 1 percent liquidity fee.

By contrast, retail funds, which are limited to individuals, can maintain a stable $1 per share price, although they are still subject to redemption restrictions and fees if they drop below liquidity levels. More than 70 percent of the $250 billion in tax-exempt money-market assets are classified retail by the Investment Company Institute. The new rules don’t apply to U.S. government money-market funds.

Even as investors fled tax-exempt money funds, yields on short-term municipal bonds have averaged 0.07 percent over the last three years as state and local-government issuance of the debt has shrunk.

Municipalities are locking in 30-year fixed rate bonds for as low as 3.2 percent rather than issuing floating-rate bonds backed by bank credit facilities. In addition, as the improving economy boosts tax receipts, state and local governments’ need for short-term financing has declined.

Government officials are also focusing more on the risks related to issuing floating-rate bonds and entering into swap agreements. Municipalities may be forced to unwind the deals and buy back their debt at great cost if their credit rating is lowered below investment grade.

Chicago faced as much as $2.2 billion in payments to banks after Moody’s cut the third-largest U.S. cities debt to junk in May. The city has approved borrowing $1.1 billion to convert floating-rate bonds into longer-term fixed-rate debt and terminate interest-rate swaps, where floating and fixed-rate payments are exchanged.

“There’s a propensity for issuers to say, you know, the last thing we want is some sort of downgrade event to trigger a swap termination,” said Lyle Fitterer, who helps oversee $38 billion of munis at Wells Capital Management in Menomonee Falls, Wisconsin.

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