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Refinancing Wave Drives Record Muni-Bond Sales as Projects Wait.

The record pace of U.S. municipal bond sales is doing little to address the deteriorating state of the nation's roads, bridges and other infrastructure.

With the Federal Reserve wavering on whether to raise interest rates for the first time in more than nine years, state and local governments are rushing to refinance debt instead as yields hold near a half-century low. They've sold more than $320 billion this year, the most for the period since at least 2003, according to data compiled by Bloomberg.

The flood will continue as governments sell about $40 billion of securities a month for the rest of the year, according to Phil Fischer, head of municipal research for Bank of America Merrill Lynch in New York, the top underwriter of tax-exempt debt during the first half of 2015. Most of the sales are for refinancing as states and cities once battered by the recession remain wary of running up new debt for public works.

"This is an environment of low yields," said Vikram Rai, head of municipal strategy in New York at Citigroup Inc. "It's a great opportunity to actually fund this country's infrastructure needs, and they're missing out on that."

The borrowing will cause the $3.7 trillion municipal market to grow for the first time since 2010, the last year of a federal program that subsidized bonds for construction projects. The dearth of new debt since and the refinancing wave has eased the fiscal pressure on state and local governments. Their annual interest payments slipped to about $188 billion by the end of June from as much as $204 billion in early 2013, according to U.S. Commerce Department figures.

Market Gains

The shift in supply hasn't tempered the market's gains, with tax-exempt debt returning about 2.1 percent through Oct. 19, according to Bank of America's indexes. That's about triple the return on corporate debt and more than the 2 percent gain for Treasuries.

Demand has been fueled by an influx of money into municipal-bond funds, which have received about $5.4 billion from investors this year, according to Lipper US Fund Flows data. Meanwhile, the refinancing has caused some debt to be paid off early.

"You've got really too much money chasing too few bonds," said Robert Miller, a senior portfolio manager at Wells Fargo Asset Management, which oversees about $39 billion of munis. "There's enough cash still on the sidelines to be invested where we can absorb additional supply."

California is among borrowers that are refinancing. The most-populous state is selling about $961 million of general-obligation bonds Tuesday in an auction among underwriters. Last week, New York's Long Island Power Authority raised $1 billion to pay off higher-cost debt.

It’s not a sure thing that the pace of refinancing will hold up, said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees $9.7 billion of munis. Many borrowers probably did so earlier this year because of anticipation that the Fed would raise interest rates by September, he said.

“I would expect the pace of refundings to decline,” said Johnson, who is based in Solana Beach, California. “There was likely some front-loading of refundings due to an expected rise in interest rates.”

Building Needs

The long-brewing need to finance infrastructure projects may drive new bond sales if refinancings wane. Governments can’t keep putting off needed work on everything from mass transit lines to water and sewer systems, said Dan Heckman, senior fixed-income strategist at U.S. Bank Wealth Management, which oversees about $126 billion of assets. The American Society of Civil Engineers has estimated that more than $3 trillion of such work should be done.

“It’s a lot of demand building up,” said Heckman, who is based in Kansas City, Missouri. “There’s a real good possibility that that will be the trigger that will change kind of this dynamic of new issuance.”

There’s a tendency for issuers to rush to the market at the end of the year, said Bank of America’s Fischer, who forecasts that bond sales will reach a record $450 billion in 2015. The bank estimates that only about a third of sales this year have raised new funds, instead of refinancing previously issued debt.

“I have a lot of confidence that we’ll get more infrastructure financing and the reason for it is I have chemistry on my side,” Fischer said. “Paint will not hold up the bridge.”

Bloomberg News

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October 19, 2015 — 9:01 PM PDT Updated on October 20, 2015 — 5:49 AM PDT