Bond Case Briefs

Municipal Finance Law Since 1971

Issuers: Don’t Let the Rating Agencies Tell Your Story – Tell It Yourself.

Despite Government Finance Officers Association Best Practices on the benefits of investor outreach, the vast majority of issuers in the municipal bond market spend very little time communicating directly with investors or engaging in investor outreach. There are a lot of good reasons for this: take the general lack of resources of governments, or the demands of other aspects of a finance director’s job. It’s not a stretch to suggest that typical GFOA members probably spend something like 90% of their time working on budgets, audits and tax collections over the course of a year, and maybe 10% focused on accessing capital in the municipal bond market.

However, a bond sale – even if it’s a once-a-year event – usually involves huge sums of public dollars. The interest costs associated with a bond sale are almost always locked-in for decades based on a single day’s pricing. And the channels to communicate with investors – things like investor websites – make it easy and cost effective even for small bond issuers to do well effectively. With the stakes so high and the channels to communicate available, issuers should engage bond investors in order to tell their story.

If you don’t tell your story, someone else will

The above adage is directly relevant to issuers as they think about attracting more investors to their bond program. Investor outreach is all about telling your story as an issuer. It’s that simple: provide some context for the financial reporting that accompanies a bond sale or an annual disclosure filing. Not only does this foster differentiation from other issuers, but its critical to clarify technical and financial content for investors so they understand where a government is headed and how they will get there.

If you’re an issuer who doesn’t communicate directly with bond investors, then investors will turn to the only other source to provide context for the raw data they are consuming: the rating agencies.

Rating agencies are a necessary and important part of the process of accessing capital. The need of investors to garner a third-party evaluation of an issuer is never going to go away. Like the reviews of a product offered on Amazon.com, rating agencies’ opinions of an issuer’s creditworthiness help buyers evaluate a bond offering. But most importantly, investors want the agencies’ context for the issuer’s numbers and the interpretation of the numbers.

Despite the value of ratings, leaving that role up to the rating agencies is a shortcoming that can create a big exposure for issuers. Rating agencies will interpret an issuer’s financial position based on their own criteria, which can change over time. They can also emphasize one aspect of an issuer’s fundamentals and not another, and they often don’t really don’t measure what’s not seen.

Let’s use debt burden as an example. For a general government, all of the rating agencies measure the affordability of a government’s outstanding debt. A lower debt burden is a credit positive relative to a higher debt burden. But what if an issuer has a low debt burden – let’s call it City 1 – simply because it is avoiding necessary infrastructure improvements? And conversely, a second government

– call it City 2 – develops a high debt burden because it aggressively tackles its infrastructure needs while interest rates are low.

If City 2 doesn't provide context for its front-loaded capital program to bond investors, it is likely to pay a penalty relative to City 1 to access the market. The key takeaway for issuers is that the opinion of a rating agency should not be the only interpretation that finds its way to the buy-side community.

Provide the context behind your government's financial performance.

To get a better sense of the value of telling your story as an issuer directly to bond investors, think about how you would go about describing yourself to a stranger. Would you simply hand him a copy of your resume? No, of course not. The resume would be a good starting point, but it would paint a very incomplete picture of who you are.

Like a resume, a financial report or audit without context provides the investor an incomplete picture. And in the muni market, audits tend to be completed and published months after the end of the fiscal year, making the data very stale. Bonds are usually structured over many decades – 20- or 30-year bond issues are common. So if you're asking for a long-term investment, it pays to provide investors with more than just stale historical financial documents.

According to Rivel Research from 2013, investors in the stock market paid a median premium of 10% to those companies that employ effective investor relations, while discounting a company a median of 20% for ineffective investor relations. That's a 30% swing in an investor's valuation based on investor outreach. For a municipal government issuing bonds, that could mean tens of thousands or more of public dollars.

Build your investor outreach program as if you were an investor

Investor outreach is not a short-term, one-off project to improve the pricing of your next series of bonds. No matter how big or small you are as an issuer, it requires a signal to the buy-side that you are a borrower that will help investors better understand your credit. But you should signal that you are committed to investor outreach for the long-term.

It certainly helps to provide more data and more documents to the market as they become public and are shared with taxpayers and ratepayers. But it's also important to inform and educate investors who may own your bonds for decades about that data. Why should an investor buy your bonds, and why should they buy now? Even if the news is bad – or perhaps more importantly if the news is bad – provide context to the data you are releasing in order to engage investors.

The story you can tell to bond investors – including about the management team – should explain where you're headed as an issuer and how you expect to get there. Bring alive your long-term financial and debt financing goals, and articulate what you trying to accomplish.

In 2017, with the availability of channels to communicate directly with investors like investor websites, an issuer should do more than simply publish historical data in a POS. Use technology to efficiently let investors know every detail about you as an issuer, because if they do, the chances of them being long-term investors – and repeat investors – will go up.

The Bond Buyer

By Colin MacNaught

August 16 2017, 10:42am EDT

Colin MacNaught is the CEO of BondLink. From 2008 to 2015 he was the Assistant State Treasurer of the Commonwealth of Massachusetts.