

Bond Case Briefs

Municipal Finance Law Since 1971

California Shows Bond Buyers Willing to Jettison Industry Staple.

- **State opted for shorter call dates after U.S. tax change**
- **Deputy treasurer says didn't pay up for different structure**

Since the Great Recession, the \$3.8 trillion municipal-bond market proved adaptable as the debt insurance industry collapsed, derivatives disappeared and the federal government created a new type of taxable security to stoke the economy by encouraging spending on public works.

If California's bond sale this week is any guide, it seems just as willing to embrace the latest change: Shorter call dates, in response to provisions in the U.S. tax overhaul that curbed governments' ability to refinance debt before it can be repurchased from investors.

When the most-populous U.S. state sold \$2.2 billion of general-obligation debt, it gave itself the option to call back most of the bonds in five or eight years, meaning bondholders could be forced to part early with what they expected to be a long-term investment. But that did little to deter demand, with buyers placing orders for twice as many bonds as were being sold and some maturities six-times oversubscribed, Tim Schaefer, California's deputy treasurer, said in an interview.

"The fact that we did this and got such good reception on it is confirmation that the market has grown to a much more sophisticated place," he said.

The sale marked the biggest test yet of whether investors would be willing to embrace the shorter call dates, though demand may have been stoked in part by the dearth of new municipal bond issues this year. Wisconsin and Utah's Davis School District sold similar securities on a smaller scale this year, and analysts anticipate that more borrowers will follow suit.

Investors accepted yields of 2.74 percent on a 5 percent coupon bond due October 2029 with an eight-year call, while the same maturity with a five-year call yielded 2.42 percent. The price of the securities edged up in subsequent trading.

The state didn't appear to pay a price for the call-option shift because the difference between the state's yields and top-rated securities was similar, or lower, than during its debt sale a year ago, Schaefer said.

While some other governments may have to pay higher yields to compensate buyers for the risk the securities will be paid off ahead of schedule, the earlier calls will preserve their ability to save money if interest rates fall.

"It's a good compromise for issuers who want that flexibility going forward, don't want to wait 10 years, and are willing to accept modestly higher rates on a yield to maturity basis and in a rate environment that is still historically quite low," said Jay Wheatley, head of Citigroup's municipal syndicate desk. "It's going to become more of the norm, especially in a low issuance environment."

Bloomberg Markets

By Romy Varghese

March 9, 2018, 6:07 AM PST

— With assistance by Danielle Moran

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com