Bond Case Briefs

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WIFIA: Examining Synergies with the Muni Bond Market

Economic gains are possible when investors with different strengths and preferences are combined in a single financing. It's happening at the WIFIA loan program.

The WIFIA loan program makes long-term loans for qualified projects at the U.S. Treasury's interest rate. Since debt capital markets start with this rate as a minimum baseline and add a spread for credit risk, liquidity premia and equity return, in theory, a WIFIA loan should always be a cheaper alternative than the market equivalent, right?

In practice, things are not so straightforward.

The vast majority of WIFIA's borrowers are highly-rated public water agencies that can access the tax-exempt municipal bond market. As in any other part of the debt capital markets, muni rates start with the Treasury curve and add in all the spread components that cold-eyed bond buyers require. But unlike the other market segments, muni investors can also *subtract* something – the value of the tax-exempt status of the overall yield. In a competitive market, the subtracted value of the tax-exemption can exceed the positive spread, resulting in rates that are lower than the Treasury curve. This depends on a lot of variable factors, but it's typically the case for highly-rated borrowers and maturities within about 20 years.

Continue reading.

Water Finance & Management

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