Citigroup, Baird Diverge Over Risk in Student-Loan Muni Debt.

- **Citi says lack of transparency makes risk gauging 'impossible'**
- **Baird, a big owner of loan agency debt, sees it differently**

Citigroup Inc., one of the biggest Wall Street underwriters, on Monday advised investors to avoid bonds sold by state student loan agencies, citing the risk that more graduates will need to get temporary reprieves from their debts.

A big buyer of the bonds disagrees.

Baird Advisors, which by the end of last year owned almost $200 million of municipal bonds sold by student-loan agencies, disputed Citigroup's view that a "lack of transparency makes it impossible" for an investor to judge the risks if growing numbers of borrowers default.

Student-lending agencies in New Jersey, Missouri and Pennsylvania are among those that post quarterly loan updates and servicing reports for bondholders, said Joe Czechowicz, a portfolio manager at Baird. In addition, investors are protected from temporary cash-flow interruptions because, in most cases, the collateral for muni student-loan bonds exceeds the amount issued.

"The forbearance rates are not that high and there's enough overcollateralization that if there was an extension of one year it shouldn't be a credit issue for any of these borrowers," said Czechowicz, citing bonds sold by New Hampshire in February that would still be able to provide full payments if almost 40% of the loans defaulted. "If 50% of the portfolio goes into forbearance, yes, we're going to have a completely different discussion in terms of what these student loan authorities can handle. But we're nowhere near that."

Lighter Regulations

The debate highlights how the loose disclosure rules that govern the $3.9 trillion municipal market can pose challenges to even the most astute professionals, given lighter regulations that apply to state and local debt issues.

Vikram Rai, Citigroup's lead muni analyst, declined to comment.

State agencies have about $18 billion of bonds backed by student loans outstanding, about $380 million of which will mature in the next 12 months, according to data compiled by Bloomberg. Since 2010, state student loan agencies haven't issued federally guaranteed loans, though some state agency bonds that packaged such securities remain outstanding. Currently, states issue bonds to make private loans that aren't federally backed.

When the coronavirus shuttered the economy last March, throwing tens of millions out of work, the U.S. Department of Education suspended loan payments, stopped collection on defaulted loans and adopted a 0% interest rate on its loans. The government extended the forbearance multiple times and President Joe Biden's administration recently extended the period to Sept. 30. Some private lenders also offered forbearances for as much as 90 days.

Baird primarily invests in private student loans, which have lower forbearance and default rates and tend to be offered to graduate or medical students with high credit scores and better earnings potential, said Czechowicz.

"You're not looking at the nineteen year old or twenty year old kid going to undergrad; you're looking at the 35 year-old in that last couple years of residency of a medical program," he said.

Balance Sheet

Citigroup's analysts in their note Monday said there's a risk that bonds maturing in the coming year will default. The analysts didn't say how many bonds were at risk.

Jeff Wagner, an investment banker at the Royal Bank of Canada who specializes in student loan bonds, said he wasn't aware of any impending defaults.

"It's true that the Biden Administration extended the payment moratorium on federal student loans, but we see no looming crisis ahead because of legal final maturity issues on nonprofit or state agency transactions secured by them," Wagner said.

RBC managed almost $7 billion of muni student loan bond sales between 2016 and 2020, according to a spokesman. The firm underwrote more than 60% of new deals during the period, according to data compiled by Bloomberg.

When student loans are in forbearance, state student loan agencies can use their balance sheet to ensure bondholders are paid on time, said Czechowicz. State student loan agencies also have the power to intercept tax refunds if students become delinquent and New Jersey's agency even has the power to garnish wages and even withhold tuition aid grants.

"Those types of levers provide an extreme incentive to continue to pay and or work with the issuer itself," he said.

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