# Bond Case Briefs

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## Muni Buyers Grab Billions in Bonds They Won’t See for Months.

- **Sales with later delivery head for record as rate risk rises**
- **Ban on tax-exempt advance refundings lifts popularity of tool**

State and local governments barred from a key refinancing tactic are turning more than ever to a funding tool that helps them avoid the risk of rising interest rates.

Sales of municipal bonds that won’t be delivered to investors until months after they price have reached about $10.5 billion in 2021, up 174% from the same period a year ago and on pace for a record, according to data compiled by Bloomberg. California issued the largest ever so-called delayed-delivery bond four months ago, while deals by issuers from across the country are set to price in the weeks ahead.

The structure allows state and local governments to lock in interest rates in anticipation of refinancing higher costing debt that’s not yet eligible to be called back. It’s an attractive tool for governments that believe rates are going to rise, said Vikram Rai, head of municipal strategy for Citigroup Inc. The structure has grown in popularity since a clause included as part of former President Donald Trump’s 2017 tax cuts banned the sale of tax-exempt bonds to refinance debt ahead of the call date.

“It’s a rate call,” Rai said in an interview. “Rates are low and I find it difficult to believe that they will go lower.”

California sold nearly $1.1 billion in April to be delivered next month, and the state plans to sell $372 million of the same structure in October. The Phoenix Children’s Hospital is selling $150.4 million through the Arizona Industrial Development Authority that will be delivered in November. And Connecticut’s Health and Educational Facilities Authority sold $206 million Wednesday that will be delivered no earlier than April.

The rising volume of forward sales comes as demand outpaces the supply of new bonds in the $4 trillion muni market, leaving yield-hungry investors willing to take on more risk to boost returns.

Rising inflation, the potential for Treasury yields to climb higher and the possibility the Federal Reserve starts tightening monetary policy could all shift future pricing for state and local governments. Ten-year top rated municipal benchmark bonds currently yield about 0.9%, according to Bloomberg BVAL pricing.

“What’s in it for us is we get the advantage of low rates,” Tim Schaefer, the deputy treasurer of public finance for the state of California, said in an interview. The state began issuing large chunks of bonds for forward delivery last October, and while it doesn’t make interest-rate predictions, it wants to benefit from the low-yield environment, he said. “All of our risk of rate fluctuation beyond the date we sign the contract is thus eliminated. We have certainty.”

Forward-delivery bonds offer extra yield to investors to compensate for the risks associated with waiting months to get your bonds. Rai, the Citigroup analyst, estimates the premium is about 3 to 4 basis points per month, meaning the further out the settlement date, the higher cost of selling the debt.

“This structure is seen as a win-win for issuers which can lower their cost of capital while investors will usually get some modest additional spread on forward delivery deals,” said Erin Ortiz, managing director for municipal credit at Janney Montgomery Scott. “In fact, investors appear as being comfortable with forward delivery deals settling much longer out, even some over one year, as opposed to three or even six months.”

Illinois’s Metropolitan Pier and Exposition Authority sold about $811 million forward delivery bonds in July to take advantage of “favorable” interest rates, said Jason Bormann, chief financial officer of the agency. A bond that matures in 2052 priced at a yield of 97 basis points over the Bloomberg BVAL benchmark, according to data compiled by Bloomberg. It generated $140 million of present value savings, the authority said. The bonds won’t be delivered to investors until March.

“I don’t see the demand changing on the issuer side unless the advance refund rules change,” Bormann said.

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*— With assistance by Skylar Woodhouse*