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Top Muni Bankers Say Huge Deals, ESG Will Be 2022 Highlights.

- **Federal infrastructure plan underpins market, spurs bond sales**
- **Public-private projects, hedging products also on the agenda**

For the municipal finance professional, the new year holds the promise of elephant-sized debt deals, a potential premium for environmentally friendly bonds and a bounty of securities sales spurred by the U.S. infrastructure bill.

So say some of the top bankers in the $4 trillion market, where debt offerings have shown remarkable resilience in the second year of the coronavirus pandemic as state and local government coffers quickly recovered.

A global vaccine campaign and a massive federal economic stimulus package helped tax-exempt municipal bonds outperform almost every other fixed-income asset class this year. The market's riskiest corner, junk bonds, was the best-performing muni sector, with returns approaching 8% year to date.

"As the economy continues to grow into 2022, and if the omicron or other variants remain in check via vaccines, we expect to see increased high-yield activity next year," said Peter Hill, head of public finance at UBS Group AG.

Bloomberg News surveyed the heads of public finance at the market's top investment banks on notable trends of 2021 and their outlook for 2022. In the following Q&A, they highlight just how important the historic infrastructure package will be to their industry. And like all bond professionals, they consider the potential effect of the fastest inflation in decades.

What sectors or geographies are you prioritizing next year?

Health care and housing, two areas drastically altered by the pandemic, continue to command attention.

"Affordable housing will be one of the defining subjects of the next decade in municipal finance and will impact our market in ways not yet known," said Charles Peck, head of public finance at Wells Fargo & Co. State and local governments sold about $35 billion of housing-related debt in 2021, a roughly 80% increase from 2020, Bloomberg data show.

Gary Hall, head of public finance and infrastructure at Siebert Williams Shank & Co., is focused on how to grow his firm's higher ed, health care and housing divisions. He also seeks to expand his firm's presence in the Southeast U.S and other rural areas.

"We're looking to go downstream in k through 12, for broadband expansion and water quality, taking advantage of the infrastructure package and any kind of bridge and tunnel work that needs to be done all throughout some of these states," Hall said.

What will be the biggest themes defining the market?

Bankers overwhelmingly cited the infrastructure package, signed into law by President Joe Biden in November, as a major determinant. Some bankers speculated whether the surge in funding will lead states and cities to pull projects off the shelf.

Jamison Feheley, head of banking for public finance at JPMorgan Chase & Co., said it should be "a catalyst for new project development against a very positive credit backdrop for states and local governments."

"The infrastructure package, the length of time it took to get enacted, paused a lot of our issuer clients. They said, 'I don't want to go out and use my bond capacity, because I don't know what's going to happen with the federal government. So I'm going to wait and see what they provide," said Hall at Siebert.

He expects the market to see a larger percentage of new-money sales than in the past boosted by "elephant-sized" deals from borrowers that aren't regular bond issuers. He's "bullish" on volume, predicting between $480 billion and $490 billion of total sales. Long-term municipal bond sales so far this year total about $459 billion, according to data compiled by Bloomberg.

What are you pitching your government clients?

"With inflation at 40-year highs, the prospect of higher rates in the future seems quite real." said Bob Spangler, head of municipal finance at RBC Capital Markets. "For new-money projects that are one to three years out, issuers should consider rate locks or other hedging products to reduce their interest rate exposures."

"As our clients return to whatever their new 'normal' is, there's a lot of potential motivators for M&A activity or other public private partnerships," Peck said. "They could be looking for ways to transfer risk that's not core to their mission, monetize assets to diversify revenue streams, or complete projects which will ultimately be owned and managed by a governmental entity."

What are the implications of federal stimulus for the muni-market next year?

In an attempt to blunt the pandemic's impact on the economy, the federal government provided a historic surge of stimulus dollars to state and local governments. Bankers at UBS, Wells Fargo, Stifel Financial Corp. and JPMorgan see a strong outlook for the sector buoyed by higher-than-expected tax receipts and spending increases.

"State and local governments are in good shape. Strong sales tax receipts, income taxes, and federal transfers have bolstered balances," said Betsy Kiehn, head of municipal capital markets at Stifel. "The question now is primarily how they spend it and whether they put in programs which require long term recurring revenue sources that are not identified."

"Increased spending and positive economic indicators should help perpetuate the positive rating trends for issuers of all stripes in 2022," added UBS's Hill.

How is ESG being viewed in the municipal bond market?

Municipals may have been the original impact investing market, with governments selling debt for decades to improve water systems, fund affordable housing and public education. In recent years, bonds specifically branded with a "green" or "social" label have grown in prominence.

Bonds classified as ESG, for environmental, social or governance purposes, are a focus for both issuers and investors. “While there are currently no measurable or consistent pricing benefits, the ability for issuers to diversify their investor base may be beneficial long term,” Kiehn said. The impact of climate change could spur more debt sales as the need grows for improvements to water systems, flood control projects and resiliency efforts like seawalls, she said.

Peck at Wells Fargo said they’ve seen a few instances of a “greenium,” that is, a relatively lower cost of capital, but overall, credit quality, liquidity and relative values are still the biggest price drivers.

“While some transactions have seen a modest pricing benefit, the real advantage to issuers is exposure to a broader, more diverse group of investors,” he said. “This can result in an indirect pricing benefit by widening distribution.”

What are you most looking forward to in 2022?

Wells Fargo, RBC and JPMorgan head bankers voiced an eagerness to return to normalcy — continued face-to-face meetings with clients and colleagues and progress toward the end of the pandemic.

“The second half of 2021 was great as we moved back to in-person interactions with clients and colleagues and I’m hopeful we can continue to move forward,” said Feheley of JPMorgan.

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