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A Muni Minute: Tit-for-Tat

Municipal investors often sift through various issues that include underfunded pensions, a lack of market liquidity, and inconsistent financial disclosure. However, there is a new area of concern that is causing indigestion among market participants: political and corporate agendas.

On April 22, Florida Governor Ron DeSantis signed a bill dissolving a handful of special taxing districts created prior to 1968, most notably the Reedy Creek Improvement District (Reedy Creek). The move was significant since Reedy Creek allows The Walt Disney Company to exert considerable governmental autonomy over the area within and around its nearly 25,000-acre theme park. Interestingly enough, the legislation was introduced not to provide any sort of societal or economic benefit, but to penalize Disney for denouncing a controversial gender bill that was signed into law earlier this year.

While the ability of the special district legislation to withstand legal challenges remains uncertain, questions still remain regarding the treatment of nearly \$1 billion of municipal bonds issued by Reedy Creek. State law dictates that outstanding bonds from a dissolved special district will be transferred to overlapping municipalities, which in this case largely includes Orange County, FL. However, whether the county chooses to honor the bonds is unclear, potentially creating a larger issue for the state and more importantly, for investors.

More troubling is that this is not the first instance in which politics have collided with the municipal market. In 2018, multiple large financial institutions began implementing policies that restricted business relationships with certain firearms manufacturers. In response, Texas Governor Greg Abbott, along with the governors of several other states that derive a material amount of economic activity from the firearms industry, signed laws that prohibited municipalities from having contractual relationships with companies that discriminate against the firearms industry. The Texas bill effectively prevented Citi Group, the largest municipal underwriter in the state, from doing business with local municipalities. Both actions caused concern in the capital markets, with the former showing the power that major financial institutions can wield to effectively cut off financing to certain sectors of the market, and the latter effectively reducing competition amongst municipal underwriters, possibly resulting in increased borrowing costs for public finance issuers.

Legislation and corporate actions fueled by political agendas that unnecessarily rile the capital markets represent a policy mistake, in our opinion, especially when the measures effectively restrict consumer choice. Investors can abstain from investing in securities that do not meet their investment criteria, and issuers have the ability to work with whichever financial institution that they believe will help them best accomplish their objectives. However, corporate policies and legislation that instead make these choices for the end user generally do more harm than good in that they tend to limit competition, push higher costs onto consumers, and are typically met with retaliatory measures.

While it is nearly impossible to predict the next target of a political attack, investors should be wary of municipalities with an overreliance on any one specific industry or company, potentially leaving them in the crosshairs of political battle between corporate America and state legislatures. We do

not foresee any related issues with municipal sectors that rely on state appropriations for a significant portion of their funding, including K-12 schools and public higher education institutions. This is because education-related funding cuts are typically politically unpalatable, and generally are only utilized in the event of a state budget shortfall. Nevertheless, we view these politically charged disruptions as one-off events, and municipal bonds remain an excellent option for investors looking for tax-exempt income with very limited credit risk.

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MAY 10, 2022

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