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DOGE Effect Stings Muni Bonds Backed by Federal Lease Payments.

Elon Musk's aggressive push to cancel federal leases is pressuring some municipal bonds backed by payments from the US government.

The White House has urged the General Services Administration, the government's real estate manager, to cut federal office space. The efforts are part of the crusade by President Donald Trump and Musk to lower spending, creating turmoil at federal agencies. Musk's Department of Government Efficiency has tweeted about some lease cancellations already.

There is a subsection of the \$4 trillion state and local government debt market backed by federal lease payments. It's hard to tally how much debt is impacted, but investors have funded hundreds of millions of dollars of debt tied to buildings like NASA's DC headquarters and an office for the Social Security Administration in Baltimore.

The campaign to cut costs and reduce the US government's office footprint is already spurring some bonds tied to GSA leases to start to sell off, amid concerns that the contracts won't be renewed. Taxable debt sold in 2022 to refinance obligations for the US space agency headquarters traded on Wednesday at a roughly 26% yield, or about 55 cents on the dollar, according to trading data collected by Bloomberg. That is about 11 percentage points wider than where the bonds traded before November's presidential election.

"These leases are kind of a political football right now," said Nicholas Venditti, senior portfolio manager at Allspring Global Investments. "You've started to see price reaction to these news stories," he said.

The NASA bonds aren't the only securities to widen. Junk-rated taxable debt sold for the Social Security Administration's office in Birmingham, Alabama, have also sold off. Those bonds traded at a yield of 27% on Feb. 11, compared to about 16% in October, data compiled by Bloomberg show. The federal government's lease on the building expires in early 2028. And bonds sold for an FBI field office in San Diego have also dropped - the General Services Administration has a lease on the building until April 2033. Even debt sold for a veterans' affairs clinic changed hands at a lower price in February.

Still, some of the trades are smaller in size, making it harder to gauge how investors across the board are evaluating the credits. Some of the bonds had lower credit ratings to begin with, in the BBB or junk range, so they already traded at elevated yields.

The falling prices for some government-lease backed bonds illustrate how the Trump administration's push to cull spending is reverberating across the US. The public finance sector is already reeling from the myriad of executive orders, with colleges and universities bracing for a reduction in research funding, and state officials challenging a proposed halt in federal grants.

Moody's Ratings downgraded the NASA bonds to junk in March 2024, and on Monday cut the

ratings again to B2, five levels below investment grade. The analysts said they see full lease renewal as less likely in 2028. The \$275 million of principal is due in 2028, and it could be harder to refinance the debt given those uncertainties, according to Moody's. "The downgrade also reflects emerging uncertainties in the GSA's general leasing strategies more broadly," according to the rating firm's report.

There are longstanding concerns with the federal government's use of office space. Biden in early January signed legislation with provisions to reform the GSA and consolidate office space, according to a press release from Rep. Scott Perry, a Republican from Pennsylvania. The Government Accountability Office found in 2023 that federal offices were underutilized amid the rise of telework. Federal agencies spend about \$2 billion a year to operate and maintain their office buildings regardless of how often they are used, the report said.

Arnold & Porter, a law firm, said in a report that there are limits on the GSA's ability to cancel leases. During what's known as the firm term of the lease, the government has limited cancellation rights, according to the report. The NASA building, financed with a \$275 million bond sale in 2022, is still in its firm term of the lease until 2028, Moody's said.

The "Trump effect" is apparent in the trading of the federal lease-backed bonds, said Jason Appleson, head of municipals for PGIM. But even before his election, Appleson said there were concerns about the federal government's office space needs, and bond valuations were starting to reflect that.

In mid-November, NASA had said it was searching for a new headquarters facility in DC. The bonds dropped in December, but the decline has been steeper more recently with the DOGE cost-cutting.

The federal government's lease payments backing the bonds can be "generous," at above-market rates, Appleson said. "If you had to re-let the building, it's questionable what you could get and what the underlying real estate could be worth," he said.

The NASA headquarters lease is one of the largest GSA leases by rent and square footage, according to Moody's.

The fallout isn't just limited to muni bond debt. About \$12 billion of loans tied to commercial mortgage bonds are also at risk, according to a Barclays Plc report last week.

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