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## **Conduit Issuer Project-Selection Process in Spotlight.**

Conduit issuers perform an important role in facilitating the financing of projects that benefit the public, but they also serve as something else: The gatekeepers who decide which conduit borrowers can access the municipal securities market.

Dave Sanchez, director of the Securities and Exchange Commission's Office of Municipal Securities, cited those roles in remarks delivered earlier this year, in which he also said that "non-governmental conduit borrowers" are "driving defaults in the municipal securities market."

From Jan. 1, 2020 through mid April of this year, borrowers using conduit issuers accounted for 75% of all impairments and 87% of payment defaults by number in the muni market, according to Matt Fabian, president of Municipal Market Analytics, an independent research and consulting firm.

Borrowers that need to use a conduit issuer to access the municipal securities market are typically riskier investments than a traditional government issuer that has direct access to the market, Fabian said.

"It's just the nature of the entity that's borrowing money," Fabian said. "A charter school or a senior living facility is inherently more fragile and more likely to default than a city."

While borrowers using conduit issuers represent a high percentage of the muni market's payment defaults, muni market defaults overall are rare, the MMA president said. Over the last decade or so, the muni market has had about 50 to 70 defaults per year, according to Fabian, who added that MMA tracks about 700 currently impaired borrowers out of a universe of 37,000 unique municipal market borrowers.

Currently just 0.75% of the market's outstanding par value - including Puerto Rico debt - is in payment default, he said.

Chuck Samuels, a member at law firm Mintz who serves as general counsel to the National Association of Health and Educational Facilities Finance Authorities, a group known as NAHEFFA for short, said that while certain areas in conduit financings do have relatively higher default rates, the actual number of conduit financing defaults "is still very small."

"The fact is conduit financings have a tiny default rate," Samuels said. "However, because the default rate in the municipal bond space is minuscule, every default that we have gets a lot of publicity."

Conduit issuers from outside the state where a project being financed is located "have a disproportionate number of the defaults or otherwise troubled bonds," Samuels said.

"And if you took them out of the equation, the number would be incredibly low," he said.

Sanchez's remarks relating to conduit financings were delivered during NAHEFFA's Winter Webinar 2026, held on Jan. 23.

Along with citing the important role the group's members play as conduit issuers in facilitating the financing of various projects that benefit the public as well as noting conduit issuers' gatekeeper role, the OMS director also highlighted "an aspect of disclosure" that he sees "as crucial to further improve the municipal securities market."

Often, Sanchez said, the process conduit issuers use to pick the projects they will be financing on conduit borrowers' behalf isn't disclosed.

"Depending upon the facts and circumstances, that may be a disclosure issue because investors may not be able to properly evaluate the level of risk they are taking on - in essence making a blind investment - when they do not have material information about your project selection process," the OMS director said.

A lack of transparency surrounding the project selection process could leave an investor unclear as to what kind of vetting - if any - a conduit issuer has performed for the projects it finances, Sanchez said.

Investors might incorrectly assume "that an issuer's involvement in the conduit financing implies a rigorous vetting process; or an investor may mistakenly assume that all conduit issuers have similar vetting processes for the projects they approve, even though, from what I have observed, these processes do vary widely across conduit issuers," he said.

Sanchez told NAHEFFA members that he's encouraged when he sees conduit issuers that have clearly stated policies or guidelines setting forth the creditworthiness standards and eligibility requirements for the projects they will finance.

He emphasized, however, that he wasn't suggesting specific standards or eligibility requirements for their project selection processes.

Still, the OMS director believes that conduit issuers that use "rating reports and feasibility studies, especially for specialized projects, and conduct an independent analysis of these reports and studies to ensure compliance with statutory and financing eligibility requirements" and subsequently share that information publicly, may put investors in a better position to weigh the risks of a conduit-financed project.

When it comes to conduit financings, investors typically can look only to the conduit borrower for repayment of the bonds, he said. If a conduit issuer or borrower suppresses information regarding feasibility studies or ratings discussions that question a project's financial viability or regarding legal opinions questioning a project's legal structure, "they may be depriving investors of material information," Sanchez said.

"With non-governmental conduit borrowers driving defaults in the municipal securities market, I believe a clear understanding of a conduit issuer's project selection process may be material to an investor's understanding of how conduit issuers, as gatekeepers, assess the risks associated with the projects they finance," Sanchez said.

Sanchez's message urging that conduit issuers be more careful about some of the financings they undertake is "a wise admonition," Samuels said.

"Although the reality is that under state law, if a borrower comes to an issuer and meets the qualifications under state and federal law, then in most cases the issuer is duty-bound to issue the bonds," he said. "But that doesn't mean that vetting and due diligence by all the people in the transaction can't improve."

Sanchez, “is a superb director of OMS,” Samuels said. “He does his job.”

The OMS director is “pushing every sector - including conduits - to improve what they’re doing in a financing, both pre-market and post-market,” the NAHEFFA general counsel said.

“We’re very supportive of that,” Samuels said. “That’s why we asked him to come talk to us.”

Conduit issuers are created pursuant to state law, “and state law gives some more requirements than others on what they can let into the bond market,” MMA’s Fabian said. In some cases, projects financed through a conduit issuer in a specific state are required to have a demonstrable benefit for that state’s residents, he said, adding that other conduit issuers, such as the Public Finance Authority, don’t have such a constraint. PFA, a Wisconsin governmental entity, is authorized to issue bonds in all 50 states.

Greater disclosure from conduit issuers regarding their project selection process would be good for investors, Fabian said.

“Knowing whether there’s no vetting or whether there’s some vetting, it just helps to manage expectations,” he said.

By Kathie O’Donnell

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