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Most Cash Since ’09 Chases Tax-Exempts Still Cheap: Muni Credit

by Michelle Kaske

Municipal securities remain cheap relative to U.S. Treasury debt even with investors directing the most cash since 2009 to tax-exempt bonds in the $3.7 trillion market.

Yields on tax-exempt debt due in 10 years were 100 percent of those on U.S. bonds with a similar maturity yesterday, the lowest since May 15, yet still exceed the 93.14 percent average for the past decade, data compiled by Bloomberg show. The ratio reached a three-year high of 126.4 percent on June 1.

Top-rated tax-exempt munis maturing in 10 years yielded 1.84 percent yesterday, equivalent to 2.83 percent after federal taxes for those in the 35 percent bracket. Investors seeking higher yields shifted money into municipal mutual funds this year as Federal Reserve Chairman Ben S. Bernanke said he would keep the central bank’s key lending rate near zero through at least 2014. The funds added $20.6 billion through Aug. 15, the most for the period since 2009, Lipper US Fund flows data show.

“There’s been a lot of money chasing munis,” said Alan Schankel, a managing director of fixed income at Janney Montgomery Scott LLC in Philadelphia. “Ratios have moved lower, but they’re still high on a historic basis.”

With muni borrowing costs near the lowest in more than four decades, cash moving into tax-exempt funds has helped issuers from California to Vermont lower borrowing costs by refunding higher-yielding debt at lower rates. Of the $237 billion sold by states and localities this year through Aug. 15, 62 percent has been for refinancing, John Hallacy, head of municipal research at Bank of America Merrill Lynch, said in a telephone interview. That’s up from 46 percent during the same period last year.

Refunding Savings

Issuance by Vermont and its localities has increased at the fastest rate among U.S. states this year. Two-thirds of the borrowings, or $314 million, were for refinancings, state Treasurer Beth Pearce said in an e-mailed letter.

The state sold $69 million of general-obligation refunding debt March 6, cutting $5.4 million of interest costs over the life of the 13-year debt, she said.

“Our debt strategies have achieved two objectives,” Pearce said yesterday in a telephone interview. “To live within our means and to employ strategies that save the taxpayers money by taking advantage of refunding opportunities.”

Bond Haven

U.S. Treasury yields sank to record lows this year as a flood of money from investors looking for a haven from the European debt crisis pushed down borrowing costs. Interest rates on 10-year U.S. securities fell to 1.39 percent July 24, while those on 10-year local-government debt dropped to 1.63 percent July 27, the least since at least January 2009, when Bloomberg data begin. Tax-exempts have earned 5.38 percent this year, beating the 1.3 percent gains for federal bonds, according to a Bank of America Merrill Lynch index.

As local governments have rushed to refinance, borrowing costs for municipals have rebounded this month along with Treasury rates. Yields on 10-year munis rose by 0.18 percentage points, the biggest increase since March, when they climbed 0.22 percentage points, according to Bloomberg data.

Municipal securities may continue to yield more than federal debt next month as issuance increases and principal and interest payments to investors decrease, Schankel said. Investors are set to receive $18 billion in September, down from $35 billion this month, Chris Mauro, head muni strategist at RBC Capital Markets LLC in New York, wrote in an Aug. 10 report.

“In September, when reinvestment drops off and, presumably, supply will pick up a little bit when everybody gets back from vacation, maybe ratios will move a little higher, Schankel said.

Following are pending sales:

BAY AREA TOLL AUTHORITY is set to issue $150 million of revenue debt as soon as next week to refinance debt, data compiled by Bloomberg show. Moody’s Investors Service rates the sale its highest grade of Aa3. (Added Aug. 17)

HOUSTON, TEXAS, plans to sell $140 million of combined utility system revenue bonds as soon as next week, Bloomberg data show. Proceeds will help finance system repairs and extensions and refund debt, according to bond documents. Fitch Ratings rates the deal AA-, its fourth-highest grade. (Added Aug. 17)

PIERCE COUNTY, WASHINGTON, is set to issue $183.4 million of sewer revenue bonds through competitive bid as soon as Aug. 22, Bloomberg data show. Proceeds will help finance capital projects, according to bond documents. Standard & Poor’s rates the bonds AA, its third-highest grade. (Added Aug. 17)

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