The Impact of Bank Financing on Municipalities' Bond Issuance and the Real Economy[1]

Ramona Dagostino, University of Rochester

Discussant: Ivan T. Ivanov, Federal Reserve Board

07/16/2019

[1] The views expressed herein are those of the authors and do not necessarily reflect the views of the Federal Reserve Board or the Federal Reserve System.

Summary and Motivation

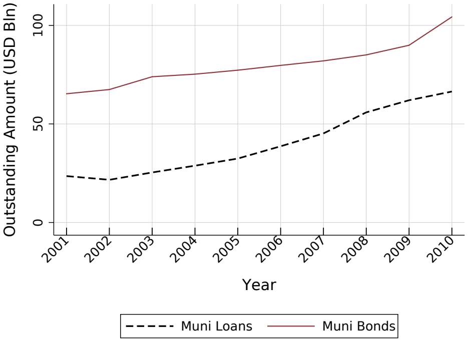
- This paper studies how discontinuities in the tax code affect municipal bond issuance and the resulting impact on the local economy.
  - Banks receive tax exemption on municipal issues in which the issuer raises no more than $10 million per year. In 2009 this limit was temporarily raised to $30 million through the end of 2010.
  - The author uses this temporary change in the tax code in combination with the proximity to the previous tax limit to identify local fiscal multipliers.
- The author finds that an additional $1 million in bank financing leads to approximately 14 additional jobs with a cost per job of $44,500. These effects appear larger in the urban counties with an additional job creation of about 22.5.

Empirical Setting and Financing Constraints

- I would include additional institutional detail on the exact specifics of what constitutes a "qualified issuer."
- The qualified tax exemption for banks derives from the issuer raising less than \$10 million in financing a year.
  - Advanced refundings, private activity bonds, industrial development, and private loan bonds typically do not contribute towards that limit – see Section 265 (b)(3)(C)(ii) of the Internal Revenue Code.
  - This means the issuer could substantially exceed \$10 million per year in total financing and still have all of its issues be qualified. Say \$10 million in a new GO bond issues + \$10 million of advanced refundings.
- Does bunching on the left of the \$10 million limit really represent financial constraints?

Empirical Setting and Financing Constraints

- Muni bank loans provide a viable alternative to bank-qualified muni bonds during the sample period in the study. I used data from the Call Reports to compare the two series.



- Muni bank loans associated with significant interest cost savings (see, Ivanov and Zimmermann, 2019).

Empirical Setting and Financing Constraints

- Do muni bank loans counts towards the \$10 million qualification limit?
    - Then the cutoff used in the paper is mismeasured.
- If muni bank loans do not contribute to the limit, then the limit is not binding.
    - Bunching on the left of the \$10 million qualification limit unlikely to represent financial constraints.
- You could use the Census survey data to understand whether this represents a problem for your study.

Identifying Local Fiscal Multipliers

- The author uses distance to the \$10 million limit to identify the effect of relaxation of financial constraints on the real economy (close vs. far).
  - I am concerned there seem to be key differences between the “treated” and “control” groups.
  - “Treated” and “control” governments appear economically different on a number of key dimensions such as revenue per capita and taxes per capita (see Table 2).
  - The lack of statistical difference appear to come from the large standard deviations in the “control” subsample.
  - The survey data are quite noisy, I would winsorize these variables to minimize the effect of extreme values.

- Could you use a narrower bandwidth to define the “treated” and “control” groups?

Prior Literature and External Validity

- Adelino, Cunha, and Ferreira (2017) also study the impact of relaxation of financial constraints of state and local governments on the local economy.
  - These authors find substantially smaller real effects (focus on rated issuers).
  - This study focuses on small issuers – bank qualified issuance of muni bonds represents a tiny fraction of total muni bond issuance ($< 5\%$).
  - While it is important to understand these effects among small issuers, I suggest reflecting this in the discussion of generalizability of the results.
- Can you identify small issuers that are rated and see if the two methodologies produce similar estimates?
  - That would tell us something about the treatment effect.

Why Do Issuers Choose Bank Financing?

- It appears that the major economic force here is cost savings.
  - Book-building and interest rate cost savings.
- Are there any differences in contract structure of bank-qualified vs. non-qualified issues?
  - Seniority, collateral, and the structure of other contract provisions.
  - That will help the reader understand if banks are indeed "special" in this market.
- Is the issuer able to renegotiate bank-held bonds? If so, how frequently does that happen?