BROOKINGS 10TH ANNUAL MUNICIPAL FINANCE CONFERENCE

Direct vs. Indirect Federal Bond Subsidies: New Evidence on Cost of Capital

Discussant: Sarah Snyder, Managing Director

Ramirez & Co., Inc.

RAMIREZ
SINCE 1971
GROW WITH US
CELEBRATING 50 YEARS

Key Historical Observations

- It is important to recognize the major structural differences in the tax-exempt market and taxable markets with respect to optionality
- Higher percentage of BABs were issued with make-whole call due to the lower acceptance of call options from investors of taxable bonds
- Make-whole calls forgo value of call option for future potential refundings for savings
- BABs issued in 2009 were predominantly issued with the make-whole call and then as 10-year par calls gained more acceptance more deals were issued with them in 2010
- Evaluating life cycle is important as municipal issuers have a history of issuing callable bonds that they anticipate refunding – over the last 10 years nearly 50% of issuance has been refundings[1]
- BABs were impacted by Federal Sequestration – reducing their "savings" and increasing budget uncertainty for municipal issuers

[1] *Source: SDC, includes categories both refundings and those with multi-purpose*

Considerations for Reauthorizing Direct Subsidy Bonds

- Overall low interest rate environment
- Healthy tax-exempt municipal market with strong investor participation
- Ratios of taxable interest rates versus tax-exempt
- Tightening of credit spreads for municipal issuers
- Taxable issuance in 2021 and 2020 is at similar issuance levels as during 2009/2010 (20-30%) compared to the average of 8%[1]
- With the increase in taxable issuance, the buyer base for taxable debt has grown
- Increased acceptance of par call options on non-index eligible taxable bonds
- Cost of par call options has decreased on non-index eligible taxable bonds
- Level of subsidy offered to issuers – 28% may not work for a higher rated issuer
- Historical use of sequestration on BABs and the lack of "trust" in the use of Federal government programs
- Incorporating direct subsidy into pledged revenues as defined by bond documents

[1] *Source: SDC*

Disclaimer

This presentation is for informational purposes only and has been prepared in conjunction with this public appearance only. As a matter of firm policy, such comments herein are for educational purposes only and shall not be used for any private publications or statements by any audience member, without the consent of Samuel A. Ramirez & Co, Inc.. The views expressed herein are those of the author and do not necessarily reflect the views of Samuel A. Ramirez & Co., Inc. Samuel A. Ramirez & Co., Inc. is not acting as a municipal advisor and this message and any opinions, views or information contained herein are not intended to be, and do not constitute, "advice" within the meaning of Section 15B of the Exchange Act of 1934. The information in this document should not be considered as research or its content be construed as a solicitation or recommendation. The information contained herein reflects prevailing conditions and our views as of this date, which is accordingly subject to change without prior notice. In preparing this material, we have relied upon the accuracy and completeness of information available from various sources and systems considered reliable, but Samuel A. Ramirez & Co., Inc. has not independently verified this information and does not represent that this material is accurate, current, or complete and it should not be relied upon as such. Bonds are subject to interest rate risk and credit risk. Bonds are also subject to various risks, including; reinvestment risk, which is the risk that principal and/or interest payments from a given investment maybe reinvested at a lower interest rate.

For additional disclosures, please refer to our full list https://www.ramirezco.com/Disclosures