RIVERBEND
Capital Advisors

Municipal Comment 1/26/18

More Munis?

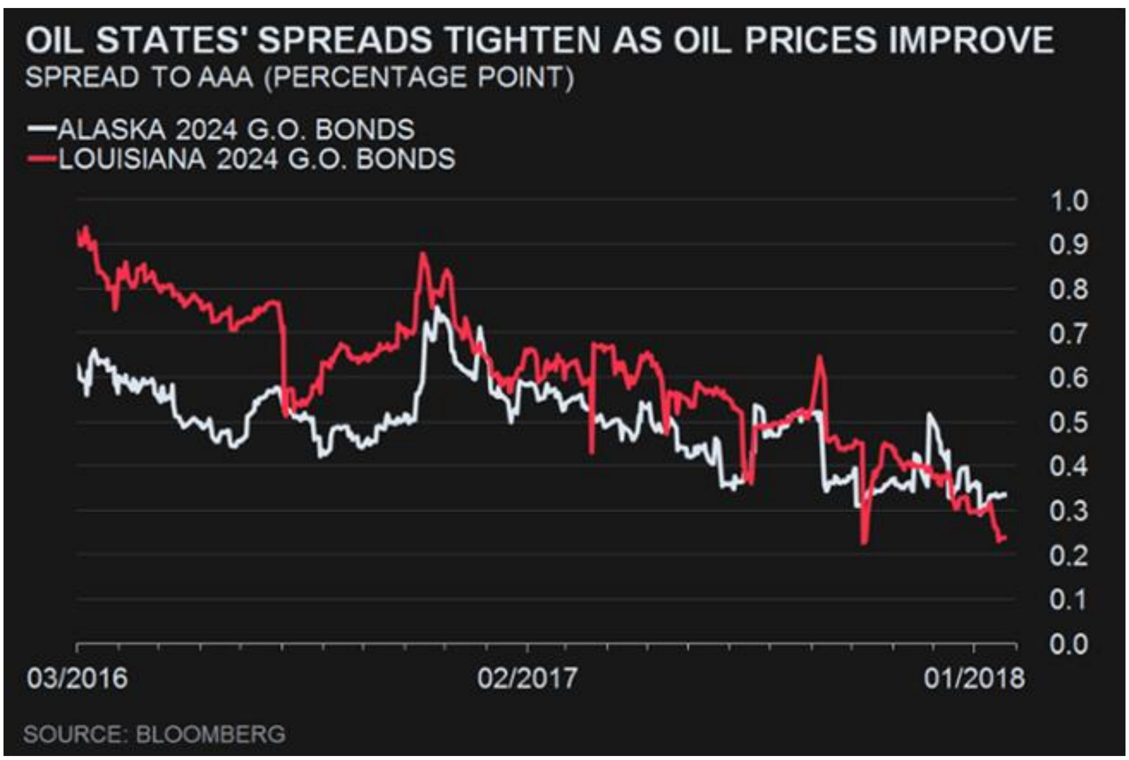
Earlier this week, portions of the Trump Administration's preliminary infrastructure plans were apparently leaked and some muni-related details emerged. Volume caps on private activity and transportation bond volumes would be removed. Advanced refundings, which were eliminated in the recently signed tax reform law, would be reinstated for private activity issues. Muni-related provisions appeared to be decidedly favorable.

PR Woes

Puerto Rico announced that it will have no money for bond payments over the next five years, as the Commonwealth continues to struggle with the aftermath of Hurricane Maria. A 19% drop in population is expected by 2022, creating a severe impediment to economic recovery. The Puerto Rican economy is expected to contract by over 11% in the current fiscal year. Benchmark PR GO 8% 2035 are trading in the $26 range. These bonds were in the $70’s last summer.

Black Gold

The oil price drop during 2014-2017 resulted in budgetary challenges for oil producing states like Alaska and Louisiana. Credit spreads for bonds in these states have tended to track oil prices, widening during this period. As oil rebounded since last summer, spreads have tightened by about 25%.



Looking Up…and Down

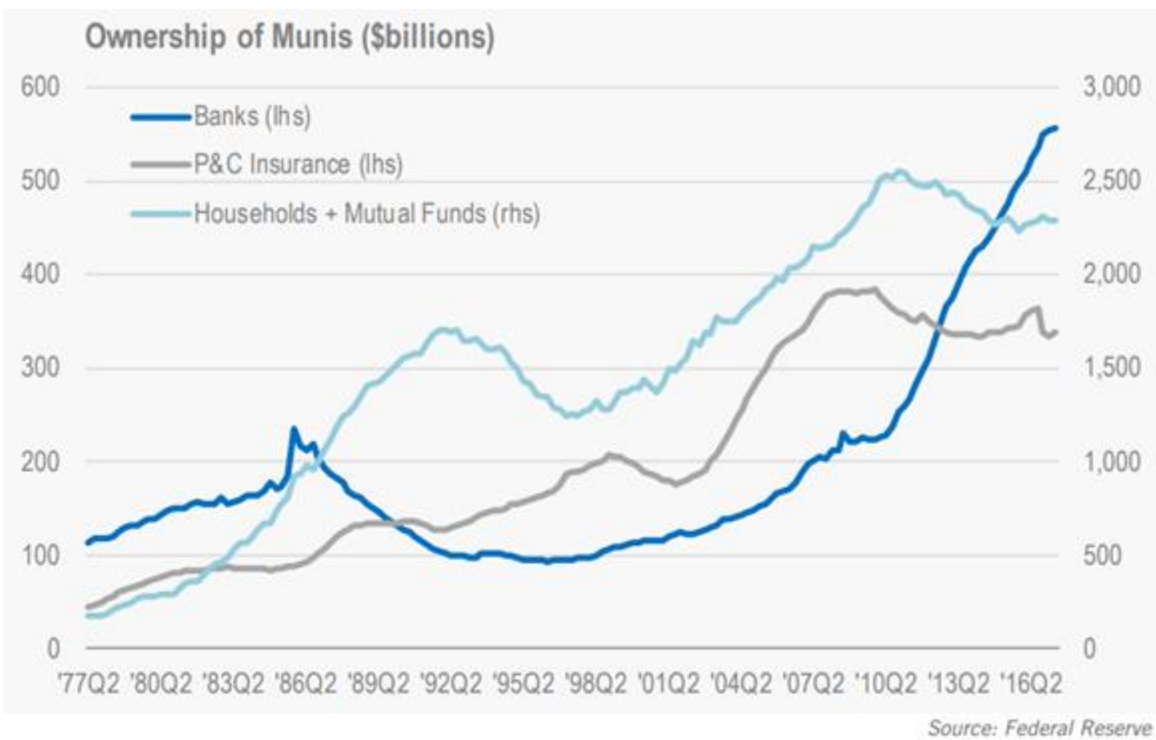
Standard & Poor's published a report indicating positive outlook for toll roads and stable outlook for airports and ports in 2018. These issuers have the ability to set rates with minimal regulatory intervention and are likely beneficiaries of the strengthening economy. S&P also has a stable outlook for the public utility sector in 2018, citing rate setting flexibility and secure revenue streams. These issuers have continued to adapt to changing economic conditions and have remained consistently solid and reliable performers. Outlook for higher education is negative. Mid-tier colleges and universities face increasing difficulty attracting students and raising money. However, more selective institutions will continue to experience rising applications and enrollment.

Deluge

The Investment Company Institute Fund reported municipal bond fund inflows of over $6 billion month-to-date. Not a record, but very strong. According to Bloomberg, last week's fund inflow of $3.5b was the largest in over a decade.

Jury Still Out

Impacts of the new tax law on muni demand are yet to be determined. The bill eliminated the use of advanced refundings, a mechanism that enabled municipalities to refinance debt and save on interest expense. Refundings represented 15% of total muni issuance over the last ten years. This diminished supply could support muni performance in 2018, especially given increased demand from investors facing the new cap on state and local tax deductions in high tax states like California, New York, New Jersey and Connecticut. This tailwind may be offset to some extent by diminished demand from insurance companies and banks, as these institutions have seen the corporate tax rate reduced from 35% to 21%.



State & Local

According to the Pew Research Center, 1Q2017 state tax collections were 5.7% higher than their peak in 2008 after accounting for inflation, yet more states reported midyear 2017 budget shortfalls than at any time since the recession ended. Most states anticipate sluggish tax revenue growth in 2018. Diminished growth creates challenges in financing expenditures related to public employee salaries and pensions, new schools, infrastructure maintenance, and Medicaid costs.

No Thanks

Aside from the ongoing Puerto Rico difficulties, muni defaults in 2017 were led primarily by retirement home and local housing issues, sectors that we steadfastly avoid. We strive to exercise prudence and avoid debt from states and municipalities whose budgetary situations we deem to be deteriorating or unsustainable, and will continue to exercise this discretion despite tempting yields and creative structures currently being offered by some issuers in the market.

Please feel free to contact us anytime if you'd like to discuss the topics cited in this update, or any others related to the municipal bond market.

Note our new location, just around the corner:

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