Municipal Market Comments

Ascent Investment Partners

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Municipal Issuance Up in 2012 as Refundings Drive Volume

Supply pressures in the municipal market have eased in 2012. Municipal market issuance to date has returned to pre-financial crisis levels, with a total of $219.4 billion of long-term municipals coming to market in the first seven months of the year. Issuance in 2012 is up more than 55%, according to data from Thompson Reuters, with volume being driven largely by refunding activity. Some market observers expect continued strength through the end of the year and even more robust issuance in 2013.

State and local governments have been taking advantage of historically low rates in the municipal market to refinance much of their outstanding debt. In 2012 to date, 43.6% of issuance has been refunding bonds. By comparison, issuance in 2011 through the month of July saw 28.7% of new issuance representing issuers refunding outstanding debt at lower rates (a figure that is roughly in line with the 10-year average).

We do not expect the jump in issuance in 2012 to have a significant impact on muni market rates. Rather, rates are driving issuance. In fact, any meaningful uptick in yield levels could stall the new issue market. Because many issuers remain financially pressured due to slow revenue growth, the appetite for new borrowing will continue to be constrained until municipal credit improves more broadly with a more rapidly growing national economy. If yields rise enough to make refunding activity less financially beneficial, we could see issuance drop.

Another factor helping to keep tax-exempt rates low are the extremely small credit spreads in taxable bond markets (the yield differential between treasuries and agencies or between treasuries and corporate bonds) that are helping drive municipal demand. Investors are sometimes able to capture greater nominal yields in tax-exempt bonds than in taxable bonds, without even considering any after-tax yield benefits. Any significant rise in yields for high-grade municipals could drive increased demand for municipals by such "cross-over buyers," as municipal bond yields become even more attractive relative to corporates or other taxable alternatives.

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