Bloomberg

Treasuries Trounced Amid Biggest Inflows Since 2010: Muni Credit

2012-02-21 By Michelle Kaske

Feb. 21 (Bloomberg) -- Municipal-debt mutual funds are drawing the most money in 17 months, helping power tax-exempt bonds to their best returns over U.S. Treasuries since 2009.

State and local securities earned 2.64 percent this year through Feb. 16 as Treasuries lost 0.45 percent, Bank of America Merrill Lynch indexes of prices and interest payments show. The difference is the most for the period in three years.

Borrowers plan $9.6 billion of sales in the next two weeks, the least since Jan. 20, according to data compiled by Bloomberg. They should see demand from municipal-bond funds, which took in $5 billion in the seven weeks ended Feb. 15, according to Lipper US Fund Flows, the most for such a period since September 2010.

"Issuance remains very low," said Peter Hayes, a managing director at BlackRock Inc. who helps oversee $105 billion of municipals. "We thought we'd begin to see a pickup by now."

States and cities are loath to spend as tax revenue stays below the peaks reached before December 2007, when the longest recession since the 1930s began. Issuance dropped to $258.3 billion in 2011, the least in eight years, Bloomberg data show.

California cut sales to a four-year low and fell to second place behind New York as the largest borrower. A $2 billion issue California plans for March will be its first tax-exempt offering since October.

Total issuance in the first six weeks of this year was $24.7 billion, about $4 billion less than average for the period since 2004, when Bloomberg data began.

Small Calendar

"We're looking out two, three, four weeks and we're still not seeing a big, big calendar," Hayes said in a telephone interview. His New York-based company is the world's biggest asset manager, with $3.5 trillion of investments. "Normally, back over the past 10 years, we'd begin to see that."

Municipal returns this year also exceed the 2 percent for company debt, the Merrill indexes show. When adjusted for price volatility, munis beat companies 1 percent to 0.5 percent, while Treasuries lost 0.12 percent, according to Bloomberg data.

Lack of supply has helped even lower-rated borrowers sell bonds and save money.

The Puerto Rico Aqueduct and Sewer Authority, which Standard & Poor's rates BBB-, one step from non-investment grade, boosted a sale of revenue bonds last week 40 percent to $1.8 billion to meet demand. It got $5.6 billion of orders.

Lower Yields

Yields on water bonds maturing in 2042 were 68 basis points less than on 30-year debt sold in 2008, according to data compiled by Bloomberg. A basis point is 0.01 percentage point.

"The market conditions were favorable in terms of the inflows," said Jose Otero, vice president of financing for the Government Development Bank, Puerto Rico's borrowing agent.
"The light supply also helped."

Buyers looking for a haven from the European debt crisis pushed down municipal and Treasury rates. Yields on 20-year general-obligation munis in a Bond Buyer index fell to 3.6 percent Jan. 19, the lowest since 1967. Thirty-year Treasuries fell to 2.7 percent Oct. 4, the least since December 2008.

Muni-bond holders are flush with cash after receiving $60 billion of principal and coupon payments in January and February, according to Chris Mauro, head of municipal strategy at RBC Capital Markets in New York. Some will be forced to buy soon, even at low rates, said Michael Pietronico, chief executive officer at Miller Tabak Asset Management in New York.

No More Pain

"People are throwing in the towel because they've been putting off their income needs" waiting for rates to go up, Pietronico, who manages $670 million of munis, said in a telephone interview. "They can't take the pain any longer."

Yields should increase as supply expands later in the year, said Neil Klein, who helps manage $650 million of municipals as senior managing director at Carret Asset Management in New York. Borrowing will rise to about $350 billion from $296 billion last year, Citigroup Inc. analysts led by George Friedlander estimated in a Jan. 13 report.

"It definitely will hold true at some point," Klein said, referring to yields rising as borrowing grows. "It's just that when demand outstrips supply, it will help keep rates low."

Following are descriptions of coming sales:

PORT OF SEATTLE plans to sell $615 million of revenue bonds as soon as this week to refinance debt sold in 1999, 2001 and 2003, according to offering documents. JPMorgan Chase & Co. is the underwriter. Moody's Investors Service rates the bonds Aa3, its fourth-highest grade. (Added Feb. 21)

SAN FRANCISCO is set to issue $344.5 million of general- obligation debt as soon as Feb. 23 through competitive bid, according to data compiled by Bloomberg. Bond proceeds will help finance earthquake-safety infrastructure, park upgrades and street repairs, according to sale documents. The deal is rated AA-, Fitch Rating's fourth-highest grade. (Updated Feb. 21)

OHIO plans to sell $120 million of general-obligation bonds for capital projects as soon as tomorrow through competitive bid, according to offering documents. Standard & Poor's rates the deal AA+, its second-highest grade. (Updated Feb. 21)

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