



# Municipal Finance Update

**Presenters:**

Eric McGlothlin | Dickinson Wright

Louis C. Orcutt | Huntington Capital Markets

Robert J. Bendzinski | Bendzinski & Co.



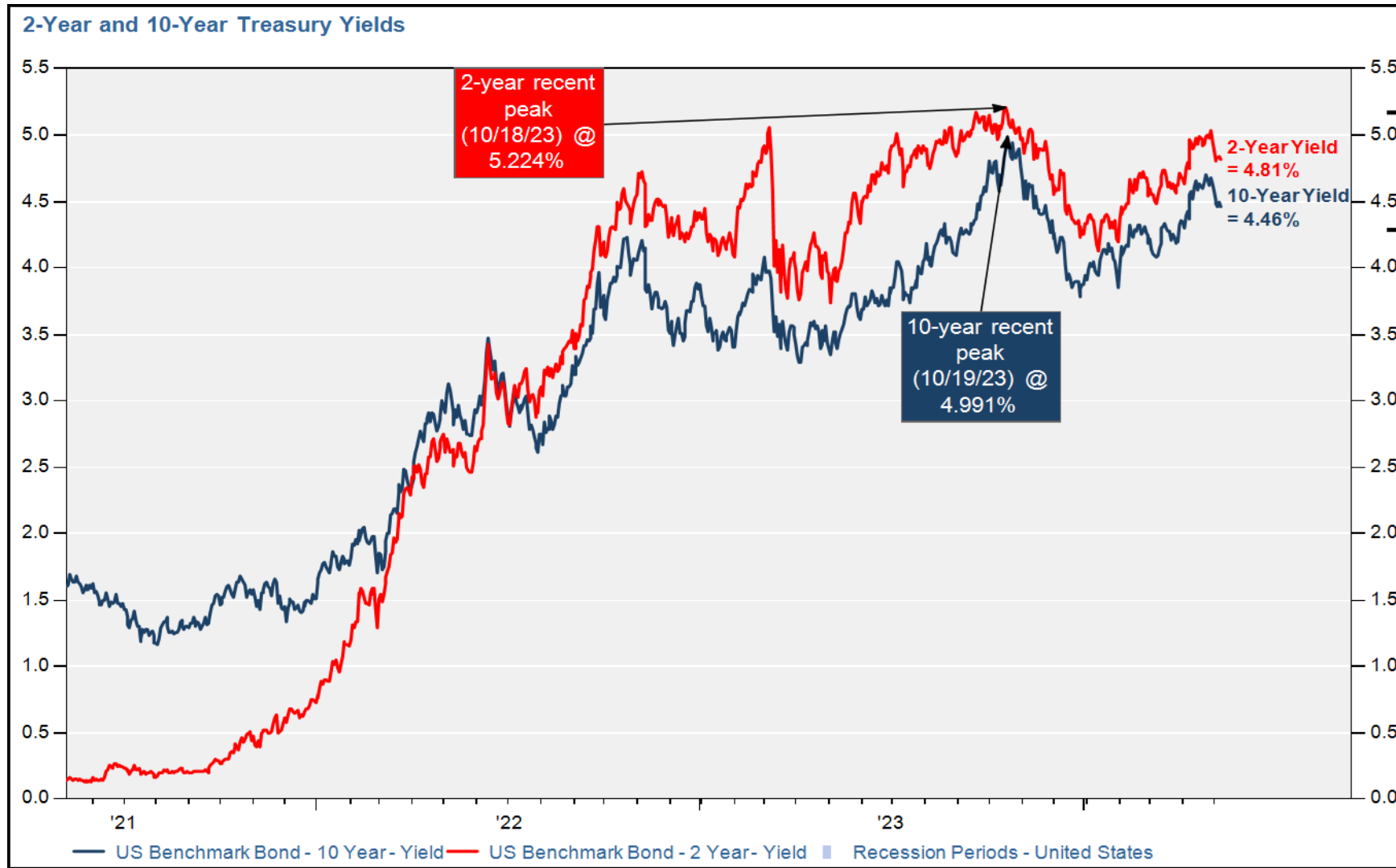


# Economic Update

# Bond and Interest Rate Markets

Louis C. Orcutt

# Treasury Yield Trends – *Market expectation is for lower yields; we are not sure*

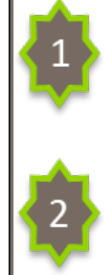
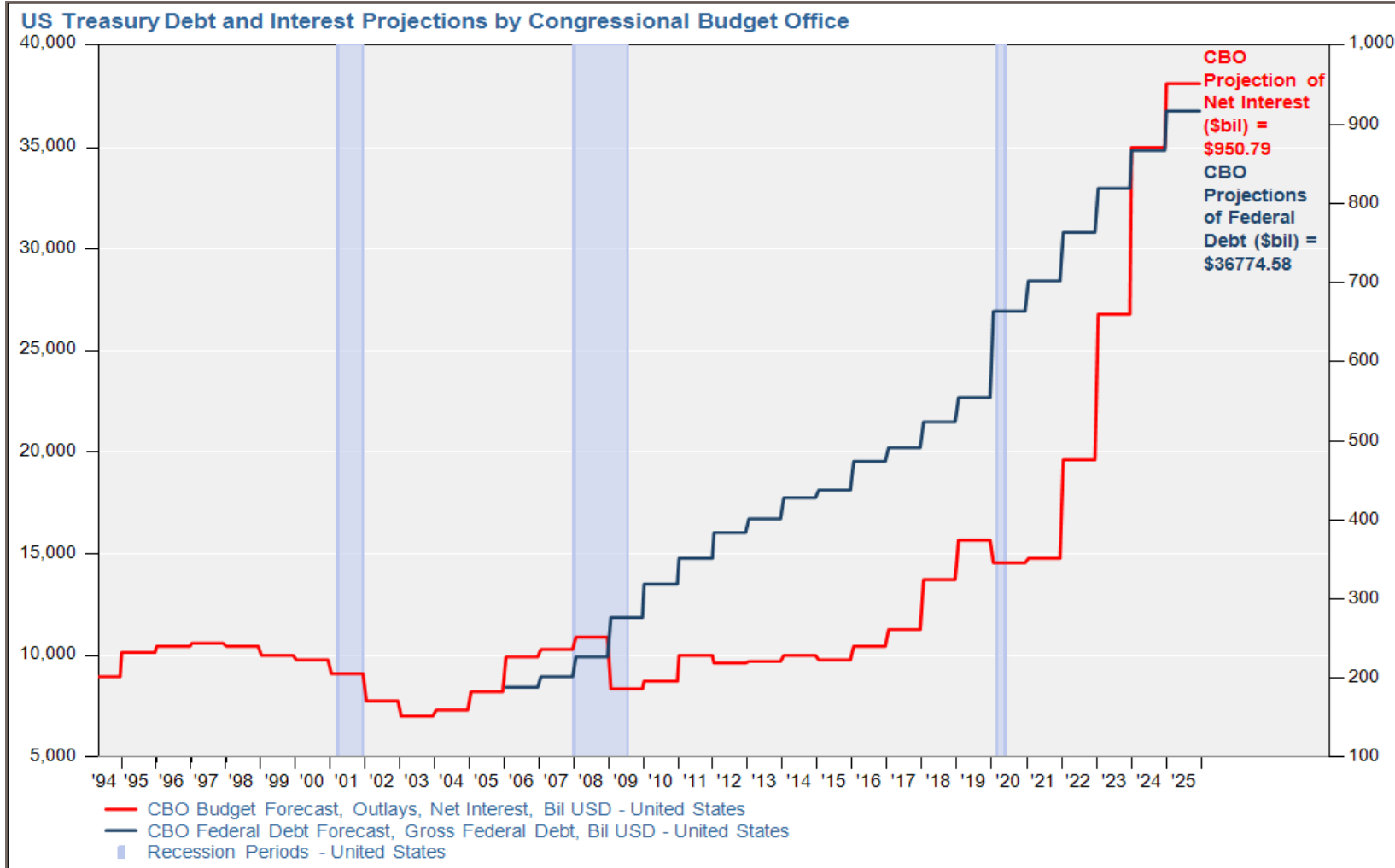


Fed (Monetary Policy) and Economist Consensus Projections – Converging views between the two groups

	<b>Bloomberg Consensus</b>			<b>Federal Reserve (SEP)</b>		
	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>
1. Real GDP Growth	+2.5%	+2.4%	+1.7%	+2.5%	+2.1%	+2.0%
2. Consumer Inflation (YoY) <i>Fed = Core PCE Deflator</i>	3.4%	3.1%	2.4%	2.9%	2.6%	2.2%
3. Unemployment Rate	3.7%	3.9%	4.1%	3.7%	4.0%	4.1%
4. Fed Funds Rate	5.38%	4.90%	3.90%	5.38%	4.63%	3.63%

\*NOTE: Federal Reserve / Bloomberg economist consensus

# US Federal Debt Interest Costs – Borrowing is not free anymore



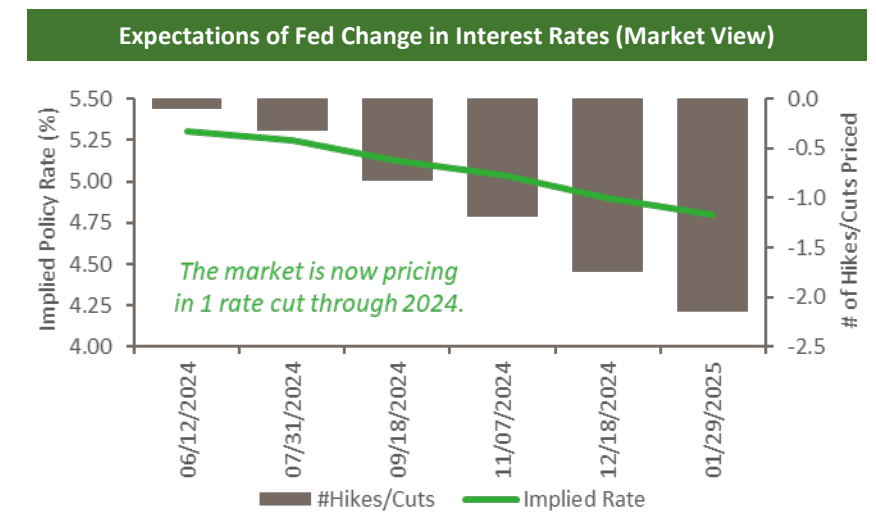
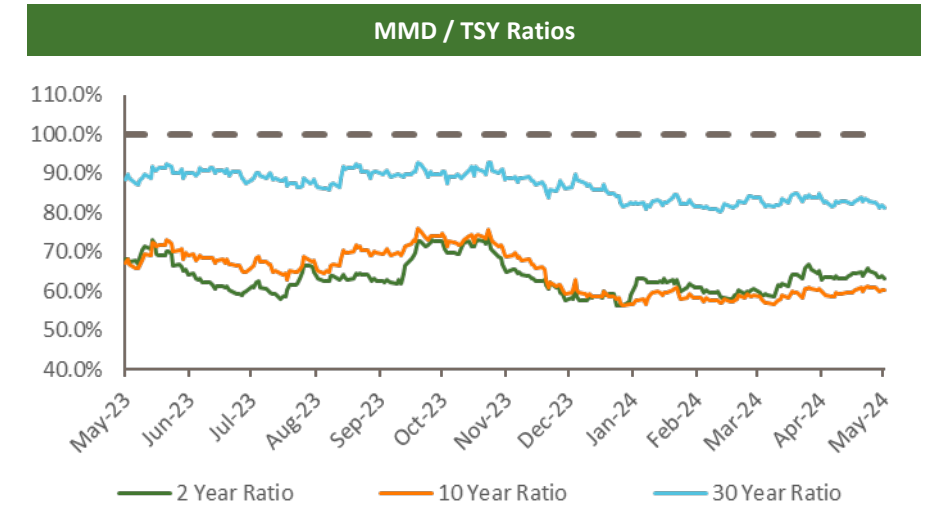
Source = Factset / CBO



## Municipal Market Technical Factors and Themes

Theme	Current Market Dynamics
Open Primary Market	\$10.8 billion in municipal issuance is scheduled to price this week, which includes \$9.6 billion of tax-exempt and \$1.2 billion of taxable issuance
Treasury Yields Increase	Treasury yields have increased up to 5 bps across the board since the prior week
Fund Inflows	Municipal mutual fund flows experienced \$1.1 billions of inflows for the week ending May 10, 2024, marking the third consecutive week of inflows and the second largest this year; <b>Net inflows</b> YTD is \$4.37 billion
Increased Investor Interest	Municipal bond prices have decreased in comparison to corporate bonds, attracting interest from investors who are looking for higher yields
Callable BABs	Issuers are expected to call up to \$30 billion of BABs this year, as they look to avoid the risk of further cuts to subsidy payments and reduce administrative burden
Short-end Pressure	Fed rate hike expectations caused MMD curve to invert in the front-end with 1-Yr MMD 52 bps higher in yield than 10-Yr MMD and transactions pricing with inverted yields in the primary market

Source: Huntington internal observations and estimates. Bloomberg long-term municipal supply. Current rates and expectation of Fed cuts as of May 13, 2024; expectations use the median of economists' forecasts as per Bloomberg as of May 13, 2024



# Municipal Market Visible Supply and Fund Flows

## LOOKING BACK

- US treasury yields were up last week, with the 10-year up 1 bp to 4.50% and the 5-year up 2 bps to 4.51%
- Weekly jobless claims increased to 231k, suggesting possible signs of a cooling labor market
- Treasury yields are slightly lower than last week, with the 10-year down 2 bps to 4.48% and 5-year down 1 bp to 4.50%

## LOOKING AHEAD

- The focus this week will be assessing inflation and growth in the US economy; April CPI figures will be released, which have come in above expectations the last few months
- Retail sales numbers for April will be released; Economists expect a 0.4% increase, compared to March's 0.7% increase
- \$10.8 billion in municipal issuance is scheduled to come this week, which includes \$9.6 billion of tax-exempt and \$1.2 billion of taxable issuance

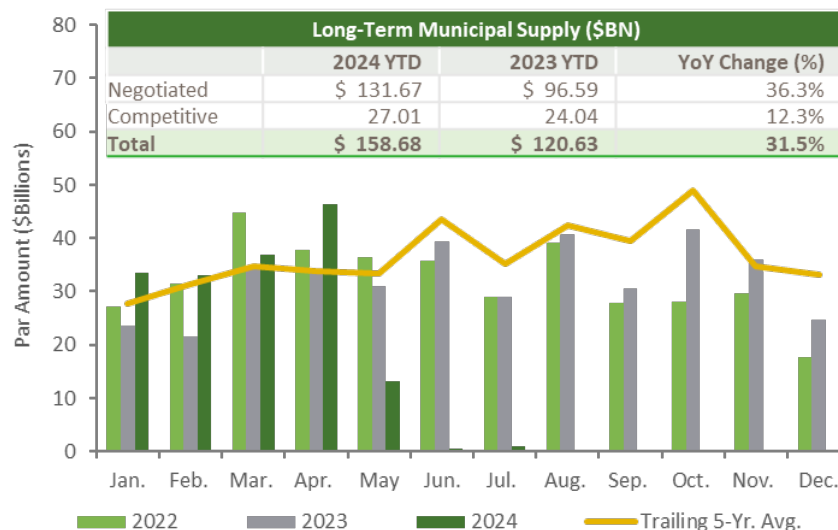
## MUNICIPAL BOND WEEKLY FUND FLOWS

- For the week ending May 10, 2024, municipal bond funds experienced \$1.1 billion of inflows
- 2024 YTD municipal bond fund net inflows have totaled \$4.37 billion

Source: Bloomberg LP Data as of May 10, 2024

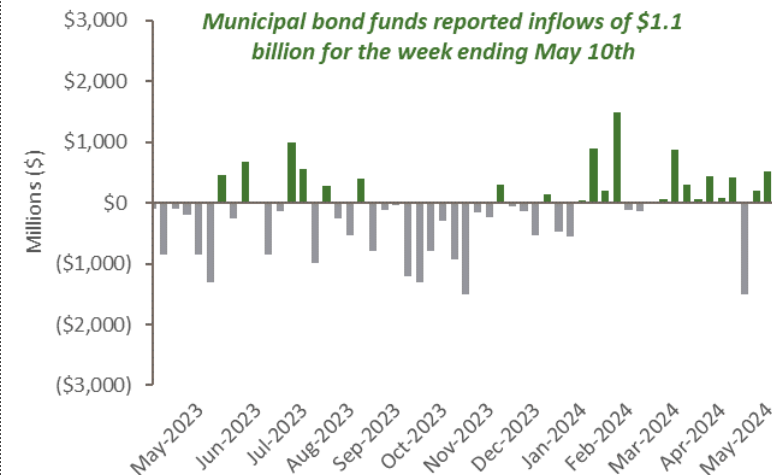
## Historic Monthly Municipal Supply

2024 YTD vs. Prior Years and Historical Averages (\$BN)



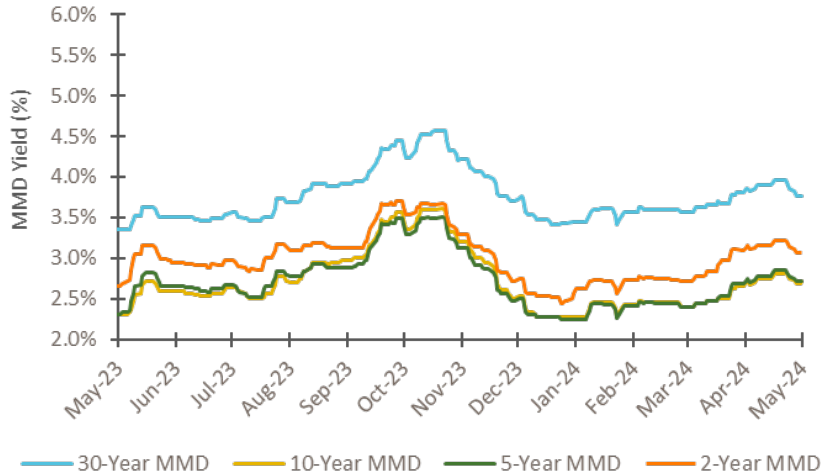
## Weekly Mutual Fund Flows

Trailing 12-Months



## Taxable and Tax-Exempt Interest Rates

### Tax-Exempt Interest Rates ("AAA" MMD)



### Taxable Interest Rates (UST)



		05/10/24	2-Week Change	YTD Change	Year to Year Change
TAX-EXEMPT	2 Year	3.07%	-15 bps	+55 bps	+41 bps
	5 Year	2.72%	-13 bps	+44 bps	+44 bps
	10 Year	2.71%	-10 bps	+43 bps	+43 bps
	30 Year	3.77%	-19 bps	+35 bps	+41 bps
TAXABLE	2 Year	4.87%	-13 bps	+62 bps	+96 bps
	5 Year	4.51%	-17 bps	+67 bps	+113 bps
	10 Year	4.50%	-17 bps	+62 bps	+105 bps
	30 Year	4.64%	-14 bps	+61 bps	+84 bps

Source: Refinitiv and Bloomberg Data as of May 10, 2024

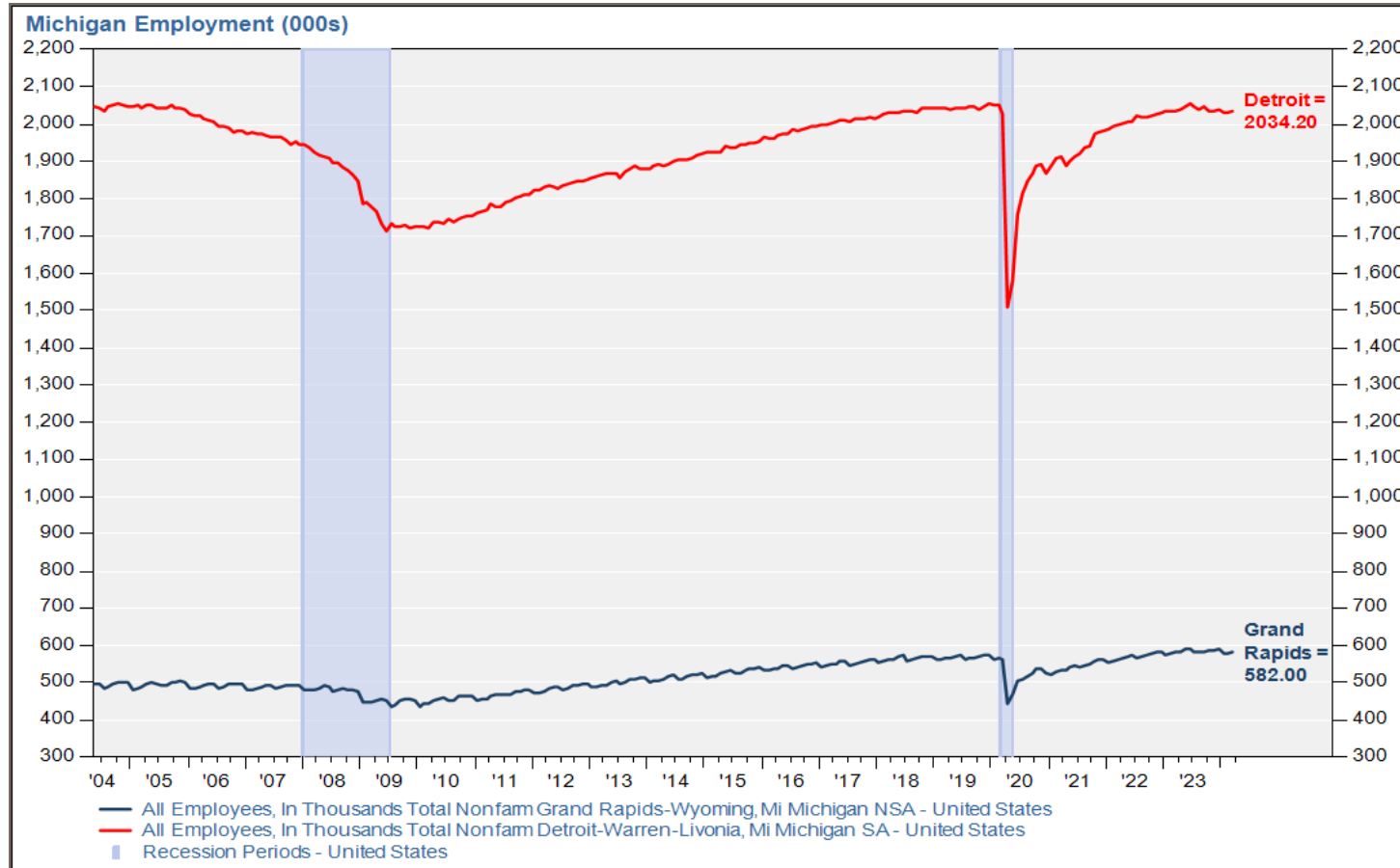




# Regional / Local Economy

1. Employment
2. Home Price trends
3. Economic output
4. Wages

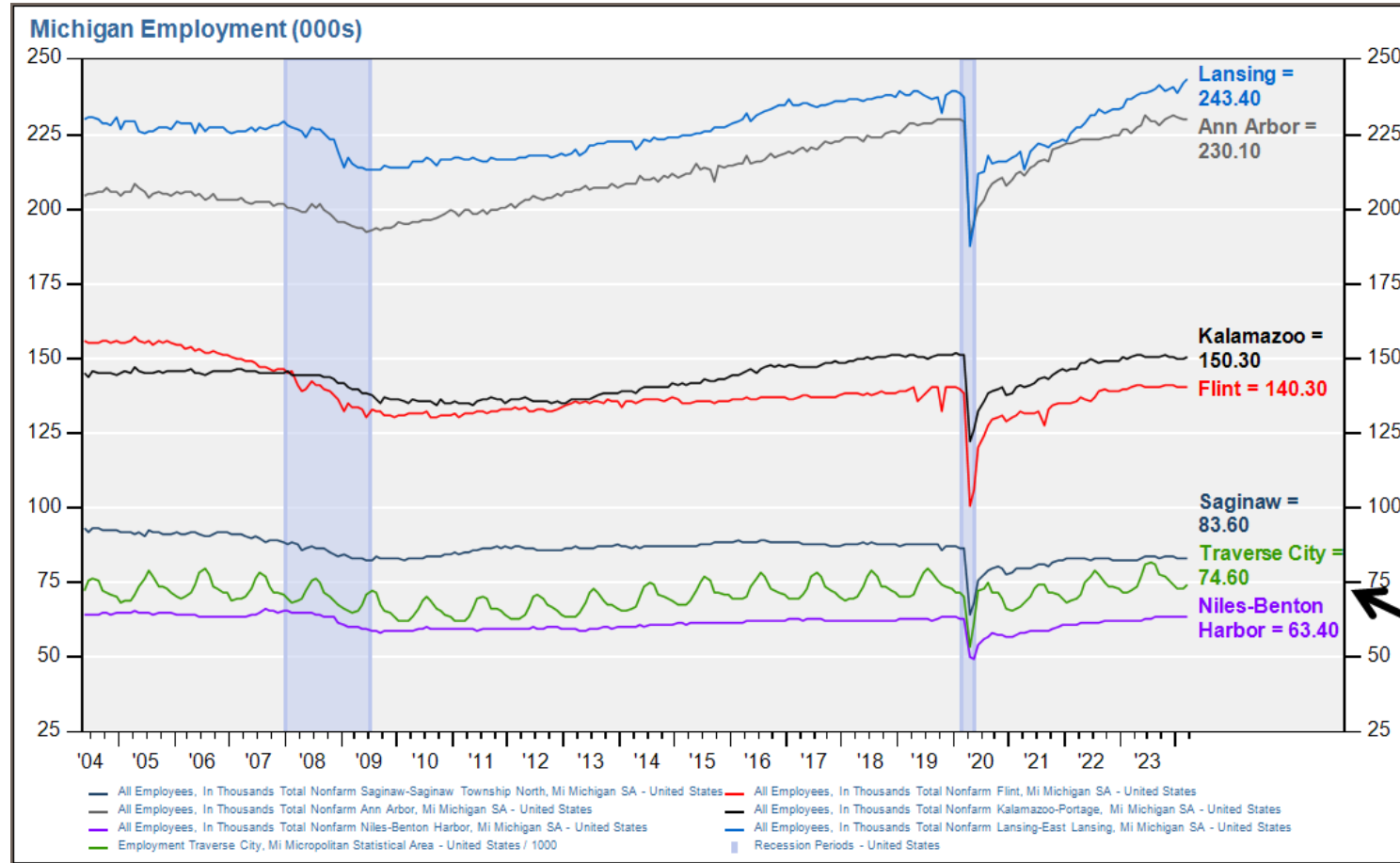
**Michigan Employment Trends –  
Grand Rapids employment has recovered above pre-pandemic level**



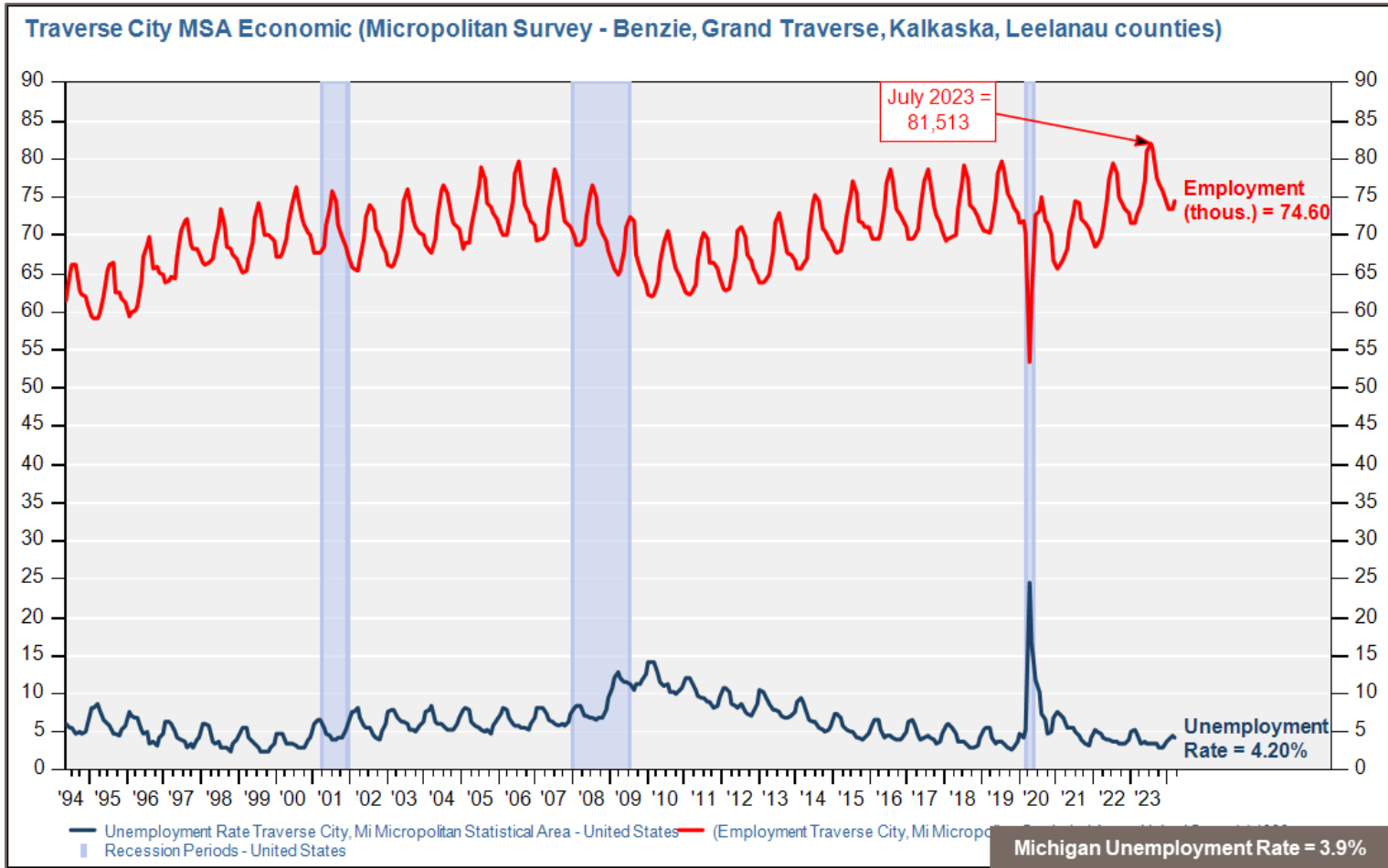
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**Michigan Employment Trends –  
Lansing and Traverse City have recovered above pre-pandemic levels**

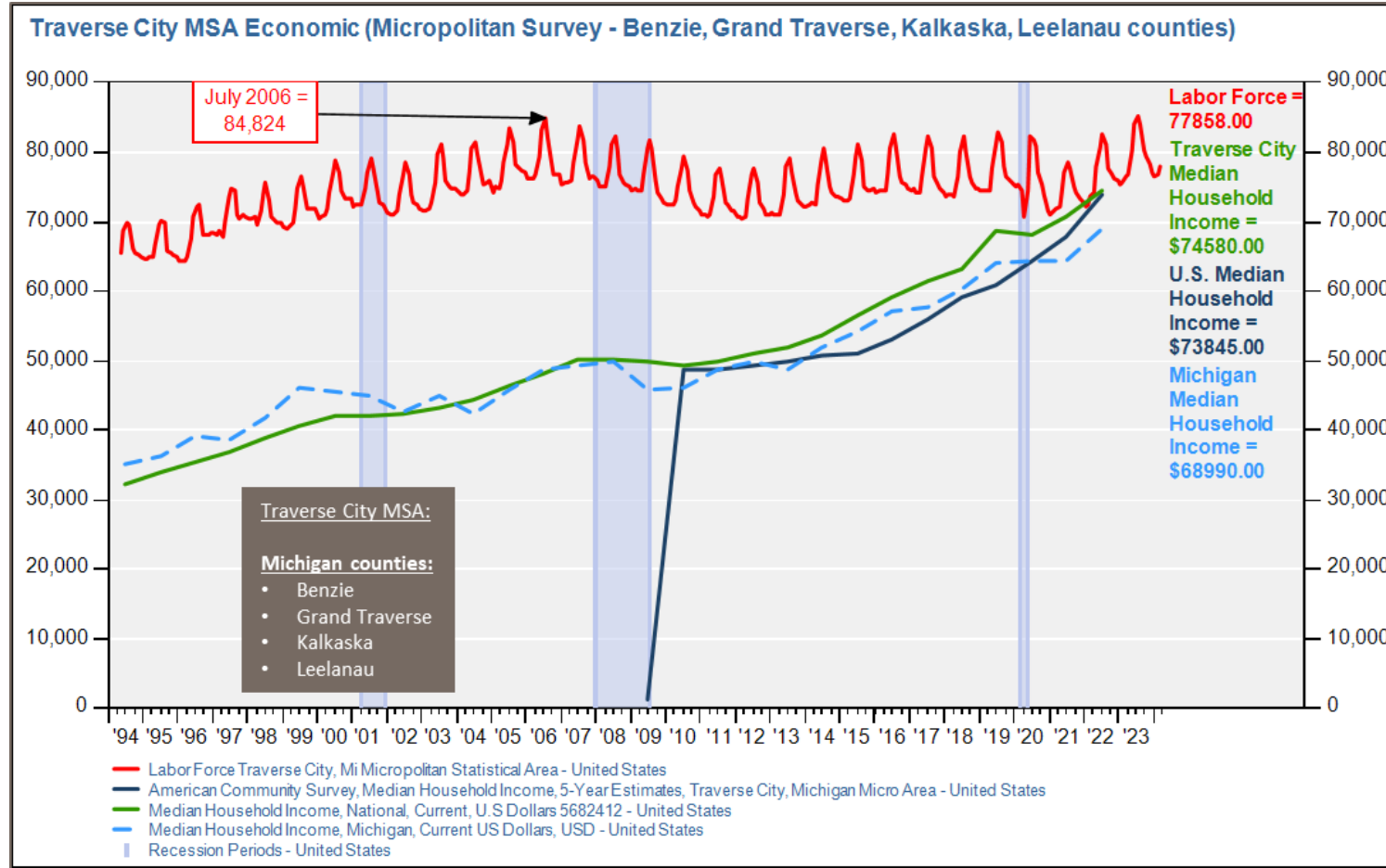


# Traverse City Economic Trends - Employment is back!



Source = Factset

# Traverse City MSA Economic Focus – Income and Labor Force moving higher



Source = Factset

# Consumers and Business – *Making your money work for you*

## What we believe:

1. Overall US economic growth is positive in 2024, with focus on U.S. consumers.
2. Borrowing costs move lower, led by the Federal Reserve.
3. Corporate earnings (S&P 500) grow by +10%.
4. US economic growth exceeds most major ex-US economic growth.
5. 2024 is an election year – *policy over politics.*



# Arbitrage

Robert J. Bendzinski



**Bendzinski & Co.**  
MUNICIPAL FINANCE ADVISORS

# Arbitrage

- **What is Arbitrage?**
- **Selling tax exempt bonds at a rate then investing the bond proceeds at a higher rate.**
- **Terms:**
  - True Interest Costs (TIC) 3.576%
  - Net Interest Costs (NIC) 3.728%
  - Bond Yield for Arbitrage Purposes 3.403%
  - Approximated Short-Term Investment Rate 4.80%



## Example

- **Bond Yield for Arbitrage Purposes 3.403%**
- **Approximated Short-Term Investment Rate 4.80%**
- **Difference (Investment Rate – Bond Yield) + 1.397%**
- **The gain of 1.397% would be Arbitrage.**

# ARBITRAGE IS NOT BAD!

# Rules to Avoid having to pay the gain to the IRS

- **Small Issuer Exemption**
  - Issue \$5,000,000 of tax exempt debt in a calendar year.
  - Six Month Spending Rule
- **Spend 100% of the bond proceeds in six months.**
- **18 Month Spending Rule**
- **Spend the following percentages:**
  - 15% in six months
  - 60% 12 months
  - 100% 18 Months

## Rules to Avoid having to pay the gain to the IRS *cont.*

- **Two Year Spend Out Rule**
- **Spend the following percentages:**
  - 10% in six months
  - 45% in 12 months
  - 75% in 18 months
  - 100% in 24 months
- **Three Year Spend Out Rule**
- **85% of the proceeds are spent within three years.**
- **If you have to pay any arbitrage earnings they must be paid within five years from the date of delivery of the bonds.**



# SEC Enforcement

Eric McGlothlin

# Securities Law Background

- **Securities Act of 1933**
  - Requires registration of securities with Securities Exchange Commission (SEC) unless exempt
  - Municipal securities are “securities” under 1933 Act
  - Municipal securities are “exempted securities” under 1933 Act
  - Registration generally not required
- **Securities Exchange Act of 1934**
  - Prohibits fraudulent, inaccurate or misleading information in disclosure documents
  - Material information may not be omitted
  - “Material” if there is a substantial likelihood that a reasonable investor would consider disclosure “significant”; “important to an investment decision”; or “alters the ‘total mix’ of information

# Securities Law Background

- **Rule 15c2-12**

- Municipal issuers exempt from direct regulation at federal level; Tower Amendment
- Municipal issuers are subject to anti-fraud laws and indirect regulation through dealers
- SEC and Municipal Securities Rulemaking Board (MSRB) rules require dealers to require municipal issuers to provide primary and secondary market disclosure
- Rule requires an Official Statement in connection with primary offering >\$1,000,000
- Rule requires annual and event-based secondary market disclosure

# SEC Enforcement



# State of Illinois





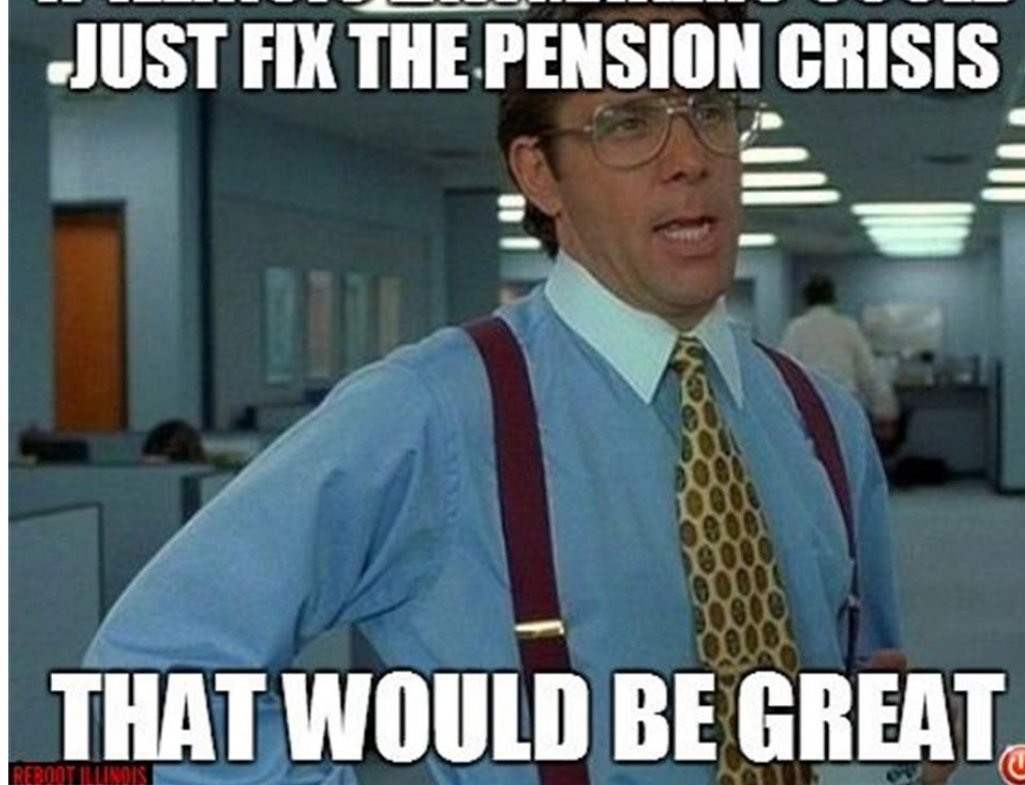
## State of Illinois, cont'd.

- **Inadequate disclosure regarding pension underfunding in connection with issuance of billions of dollars of bonds**
- **Failed to disclose structural underfunding**
  - 50-year payment schedule heavily back loaded
  - Statutory scheme did not provide enough for normal costs or amortization of unfunded liability
- **Misled investors on effect of pension holidays**
  - Disclosed fact but not effect
  - Substantially reduced contributions

## State of Illinois, cont'd.

- **Insufficient policies and procedures to assemble material information and communicate it to personnel responsible for disclosure**
- **Failed to train disclosure personnel or hire disclosure counsel**
- **Heightened scrutiny of pension disclosures by SEC and rating agencies**

**IF ILLINOIS LAWMAKERS COULD  
JUST FIX THE PENSION CRISIS**



**THAT WOULD BE GREAT**

# The City of Harrisburg, Pennsylvania



“Money-Losing Trash Incinerator”

## City of Harrisburg, PA

- **City guaranteed ~\$260 million of Authority bonds for acquisition and construction of trash incinerator owned by component-unit of City**
- **Ability of Authority to pay debt service dependent on rate increase that it did not get**
- **Completely failed to comply with CDU to provide annual financial and operating data**
- **Created an “information vacuum;” investors “had” to look to other public statements that misrepresented finances**

## City of Harrisburg, cont'd.

- **Misleading statements made outside of securities disclosure documents**
- **Statements made in City's budget report, annual and mid-year financial statements, and Mayor's State of the City address**
- **Financial statements failed to disclose guarantee payments or the extent of financial difficulties**
- **Misstated credit rating as Aaa vs. actual Baa1**

## City of Harrisburg, cont'd.

- **Public statements reasonably expected to reach the securities markets—even if not intended to—can't be materially misleading**
- **No policies to ensure public statements were accurate or compliance with CDUs**

# City of South Miami, Florida



Mixed-Use Public Parking Garage



## City of South Miami, FL

- **Borrowed \$6.5 million tax-exempt proceeds to construct and operate public garage; certified no private use**
- **Less than one month later, loaned \$2.5 million to developer constructing private retail portion of structure**
- **Amended lease to give developer management duties and share profits**
- **Jeopardized TE status but didn't disclose for ~8 years**
- **Borrowed more TE proceeds to complete**

## City of South Miami, cont'd.

- **Finance Directors certified annually that there was no change in use**
- **Finance Directors had no experience with disclosure matters or tax issues with TE bonds**
- **Settlement required active ongoing training for City Attorney(s), Manager, Mayor, Finance Director, and Commissioners**

# City of Miami and its Budget Director, Michael Boudreaux

The Shell Game



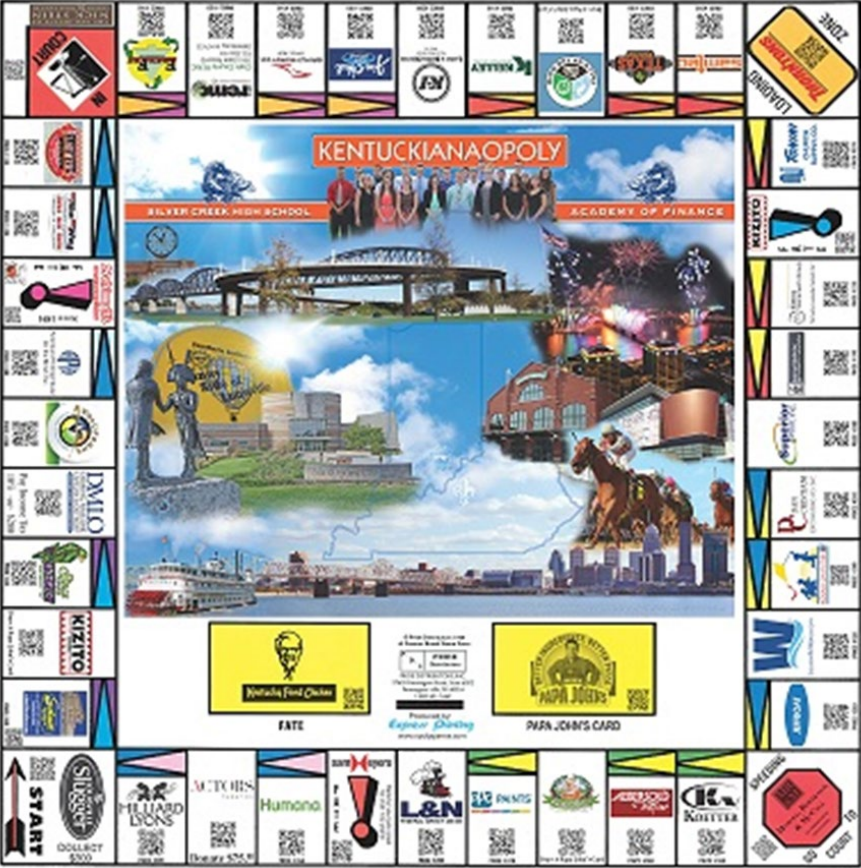
# City of Miami

- **Budget Director effected series of interfund transfers to City's General Fund**
- **Purpose was to mask increasing GF deficits, meet required reserve levels under City law, and prop up City's ratings**
- **Transfers included legally restricted funds (storm water impact fees) and other capital improvements funds**
- **Funds were allocated to projects that still needed funds for completion or were funds that had already been spent**
- **Did not disclose true nature of transfers in official statements for series of bond issues**

## City of Miami, cont'd.

- **Violations found against City and Boudreaux**
- **Boudreaux aided and abetted City's violation**
- **City settled in fall of 2016 for \$1,000,000**
- **Boudreaux ordered to pay \$15,000**

# West Clark Community Schools



Kentuckiana, we have a disclosure problem.

# West Clark Community Schools

- **West Clark issued bonds and agreed to provide annual reports with updated financial and operating information**
- **NEVER filed ANY annual reports**
- **Issued more bonds a few years later**
- **Stated in the OS that it had not failed to comply in all material respects with any prior CDU; certified no material misstatements/omissions in OS**

## West Clark Comm. Schs., cont'd.

- **First time the SEC charged a municipal issuer for false disclosure about disclosure**
- **West Clark settled by agreeing to undertake remedial actions**
  - Adopt written disclosure policies
  - Designate person responsible for compliance
  - Annual training for personnel involved in bond offering and disclosure process
- **Unleashed MCDC on municipal sector and tail now wags the dog**



# The Port Authority of New York and New Jersey

All  
Roads  
Lead



To  
Authority

## Port Authority of NY and NJ

- **Paid \$400,000 to settle charges that it failed to disclose known risks to investors**
- **Known risks stemmed from advice of bond counsel that there was “no path to legislative authority” to expend proceeds as originally proposed**
- **Memo revised to link roadway projects to legislative authority**
  - Cited departure from traditional model used by PA to determine authority for project

## Other Actions

- **Greater Wenatchee Regional Events Center Public Facilities District (WA)**
  - \$20,000 fine imposed upon municipal issuer
- **Harvey, IL**
  - Obtained injunction to prevent city's pending bond issue
- **Victorville, CA**
  - Defrauded investors by selling tax increment bonds on basis of inflated property values
  - SEC sought return of ill-gotten gains with prejudgment interest and civil penalties vs. City and Airport Authority

# Avoid SEC Aggression

- Evaluate your issuer's disclosure process
- Identify disclosure personnel; assign responsibility to a person and position; and train personnel
- Consider need for a dissemination agent
- Consider hiring disclosure counsel
- Adopt disclosure policies

# Key Features of Disclosure Policies



- Establishes process for identifying, assembling, and communicating material information
- Designates person and position responsible
- Provides for periodic training
- Policy must make sense for your issuer; a policy that isn't followed is a “weekend case” for your friends at SEC

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