THE BOND BUYER

Muni bonds can help achieve racial equity

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Municipal bonds have a significant role to play in achieving racial equity as investors' appetites grow for social impact bonds.

A subcommittee of the House Financial Services Committee heard from muni stakeholders on Wednesday regarding how the muni market could address disparities within itself. Specifically, lawmakers discussed a study that found that historically Black colleges and universities pay more in issuance fees than non-HBCUs.

Rep. Al Green, D-Texas, led the hearing on Wednesday. **Bloomberg News**

“These findings are at once both deeply personal and profoundly troubling,” said Rep. Al Green, D-Texas.

In a 2018 report — “What’s in a (school) name? Racial discrimination in higher education bond markets” — Chris Parsons, finance professor at the University of Southern California found that HBCUs pay more in issuance fees compared to non-HBCUs. HBCUs pay about 20% more in fees to underwriters and that goes up to as much as 30% for schools in the deep South with historically high levels of racial animus.

Parsons collected data on 4,145 college-issued municipal bond offerings between 1988 and 2010 — 102 of those were conducted by HBCUs.

Parsons found on average that HBCU-issued bonds appeared to trade at somewhat lower prices than similar non-HBCU bonds, though not statistically significant. However, he found that when HBCU bonds are traded, it takes about 23% longer to find a willing buyer.

“Due to tax reasons, municipal bonds offer the largest advantages to investors residing in the same state as the issuer,” Parsons said. “What this means is that HBCUs, by virtue of being located mostly in the American South and Southeast, may face collective reluctance from what should be their most receptive investor base.”

“What we found in the paper is that the institutions in these states where HBCUs are disapprorptiatley located similarly seem reluctant to have these bonds as part of their portfolios,” Parsons told The Bond Buyer.

Parsons called on lawmakers to grant bonds issued by HBCUs a triple tax-exemption from federal, state and local taxes, treating them the same way as Puerto Rico debt.

Gary Hall, a board member of the Securities Industry and Financial Markets Association and a graduate of Howard University, an HBCU, told lawmakers Wednesday that state and local governments are increasingly financing projects that align with environmental, social and governance goals.

“SIFMA and its members understand that America’s capital markets can play an important role in enabling and financing programs to combat generational hardships such as poverty, racism, climate change, and other critical infrastructure needs,” Hall said. “It is especially worth noting that municipal bonds can also be leveraged in terms of sustainable finance.”

Hall said times have changed since the 2018 study. The data from 1988 to 2010 does not take into account increased transparency in the secondary market through the Municipal Securities Rulemaking Board's Real-time Transaction Reporting System where trade prices have to be reported within 15 minutes of the time of the trade. EMMA only existed at the very end of the timeframe covered by the study.

Hall was also a past MSRB chair.

"The study readily admits that the availability of bond pricing data is important to investors and that bonds that traded relatively infrequently, such as HBCU-issued bonds, were more prone to delayed reporting which may have contributed to a 'differential information environment' relative to other bonds during a significant period of the study," Hall said. "Given the RTRS reporting requirements, no such 'differential information environment' exists today."

Despite that, Hall said more could be done to help HBCUs access capital markets more cost-effectively going forward.

The appetite for social impact bonds is growing.

The municipal bond market saw a volume spike of such issuances to $154 billion in 2020 versus $17.9 billion in 2019, Hall said.

Other ways to expand the buyer base for HBCU bond issuance could be lawmakers authorizing a high-subsidy direct pay bond or a federal guaranty on taxable direct pay bonds for HBCUs, Hall said.

HBCUs currently get funding through the Department of Education's HBCU Capital Financing Program, which provides low-cost loans to finance and refinance infrastructure improvements. Biden also said Wednesday he plans to invest more in HBCUs.

Seventy-nine HBCUs face on average $46 million of deferred maintenance costs according to a 2018 Government Accountability Office study. Also, 39% of HBCU buildings on average are in need of repair.

The Bond Dealers of America wrote in a testimony that impediments such as HBCUs receiving more of their revenue from government sources than non-HBCUs can be seen as too much reliance on any source of financing — a negative view by rating agencies. HBCUs also receive less revenue from tuition and fees compared to others, another negative for rating agencies.

To help HBCUs, BDA saidd that Congress should provide a triple tax exemption for HBCU bonds, promote developing ESG standards, increase the cap on bank-qualified bonds and restore tax-exempt advance refunding.

Rep. Emanuel Cleaver, D-Mo, also mentioned socioeconomic risks on municipalities. He mentioned Ferguson, Missouri's ability to get significant bonding flexibility. Ferguson is where an unarmed Black man, Michael Brown, was killed in 2014 by a police officer.

Ferguson is a town of about 21,000 people, and yet, Ferguson police issue 32,000 traffic tickets a year, Cleaver said.

"We call that policing for profit," Cleaver said.

"If you have a town where you have revenue focus on policing and a declining tax base, it means that you're going to have a difficult time getting anything done as a municipality," Cleaver added.

Socioeconomic factors like poverty, diversity of employment all factor into a risk of a municipality and their ability to get significant bonding, Cleaver said.

For HBCUs, increased borrowing costs mean investments in physical facilities and academic programs suffers and increases the costs of attendance, said William Fischer, CEO of the Rice Capital Access Program.

"For example, increased costs associated with the financing of the investory are borne by the student through higher student housing fees," Fischer said.

The impact of expensive debt also affects local communities, he said.

Jim Nadler, CEO at Kroll Bond Rating Agency, talked about social and economic issues' impact on municipal bonds on Wednesday and investor interest.

"Municipal bonds by their very nature have material attributes of positive social impact that deserve amplification," Nadler said. "Those that do not will suffer by not having that type of analysis to show on their behalf."

Investor preferences will continue to drive pricing and liquidity in favor of a municipality that has exhibited economic, racial and social justice, Nadler added.