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Municipal Note Volume Dips Amid Rising Tax Receipts, Federal Relief

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Municipal note issuance in the first half of 2021 was down from a year earlier as states and municipalities had less need for short-term borrowing amid recent COVID-19 federal aid and rising tax receipts.

Issuance dropped to $16.49 billion in 960 deals in the first six months of the year, from $19.17 billion in 1,047 deals compared to the first six months of 2020, according to Refinitiv data.

“Parsing the short-term note issuance data through the first half of 2021 reveals little to no surprises,” said Jeff Lipton, head of municipal credit and market strategy and municipal capital markets at Oppenheimer & Co.

First half note data contains "little to no surprises," said Jeff Lipton, head of municipal credit and market strategy and municipal capital markets at Oppenheimer & Co.

“The significant drop in muni short-term note issuance relative to the same period of last year can be directly attributable to stronger-than anticipated tax and other revenue receipts coming into municipal governments as well as to heavy doses of stimulus allocations from the federal government,” Lipton said.

Volume was down almost all of the first half, the figures show.

February and June issuance fell 32.5% and 27.8% year-over-year to $1.19 billion in 108 deals from $1.77 billion in 119 deals, and to $7.48 billion among 304 deals, compared with $10.36 billion among 340, respectively, according to the data.

Issuance also fell 22.3% in April and 19.1% in May to $1.41 billion in 134 deals from $1.82 billion in 161 deals and to $1.57 billion in 160 deals from $1.94 billion in 190 issues, respectively, compared to last year’s volume over the same period.

March was the only month that note volume grew noticeably, by 96.3%, as issuance increased to $2.63 billion in 148 deals from $1.34 billion in 99 deals the prior year.

The overall year-to-date trend in note issuance is occurring while total bond issuance is up year-over-year for the same period, Lipton noted.

“Volume is showing difficulty satisfying strong demand for product, particularly given rather material net negative supply conditions now being experienced through the cyclical summer months,” he said.

“With deepening penetration of the COVID-19 vaccinations, municipal operations, consumer engagement, and job formation are operating in full recovery mode, allowing restoration of fund balances for many municipal issuers,” he said.

Alternative funding options also contributed to the overall decline in note issuance in the first half of 2021, even though with the dearth of short-term paper, short-term rates have experienced noted downward pressure, according to Lipton.

Note issuance from state agencies dropped 69.9% to $1.08 billion in 19 deals from $3.58 billion in 10 deals last year, according to Refinitiv.

State government notes fell by 61.6% to $868.3 million in four deals, versus $2.26 billion in five deals in 2020’s first half. A 51.1% decline in note issuance among local authorities saw volume in that sector drop to $523.7 million in 28 issues, versus $1.07 billion in 40 issues in the first six months of 2020.

“Against a backdrop of favorable revenue collections, a number of traditional note borrowers have been able to avoid the short-term market for cash flow purposes and have instead relied upon better budgetary performance to match up revenue and expenditure figures,” Lipton said.

In certain areas of the country, he noted, current tax collection performance is surpassing pre-pandemic experience, as it did in the first half, resulting in less need for short-term borrowing and declining note volume.

Negotiated pricings accounted for $6.7 billion on 172 transactions, down 9.2% by volume year-over-year, according to Refinitiv.

Competitive note deals were up 3.3% to $9.2 billion on 761 transactions. Private placements were down substantially, to $583 million from $2.9 billion.

More notes were sold out of California — $5.7 billion — than from any other state. New York was second at $4.2 billion.

Taxable note issuance was one of the only sectors where volume grew, paralleling increasing taxable bond issuance in the long-term market.

Issuance of taxable notes grew by 35.7% to $1.61 billion in 99 deals from $1.18 billion in 79 deals in the six months of 2020.

“Through the remainder of this year, unless there is some unforeseen event which triggers fiscal stress and undermines growth expectations — such as a more onerous Delta variant impact upon revenue performance — we see overall note issuance patterns reflective of currently sound and stable credit conditions,” Lipton explained.

At the same time, Lipton said more note issuance could be on the horizon depending on economic and market forces ahead.

“Once the wall of stimulus is largely taken down, some of the weaker and less fiscally agile governments may face some real credit headwinds, thus possibly resulting in a note issuance course correction that may occur as early as next year,” he said.

“We suspect that issuers are also paying attention to monetary policy and prospects for a renewed cycle of Fed tightening, which may very well motivate a number of issuers to take advantage of today's currently low interest rates at some point starting next year,” Lipton added.

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