THE BOND BUYER

Michigan universities' century bond deals offer risk needle for the market

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Published

March 14, 2022, 4:07 p.m. EDT

Recent university century bond deals will serve as a bellwether check going forward to gauge market appetite for risk, CreditSights said.

The $1.2 billion University of Michigan deal that priced Wednesday landed at 4.45%, a 210 basis point spread to the 30-year Treasury. Refinitiv Municipal Market Data evaluates the bonds at a 199 bp spread. The university carries triple-A ratings from Moody’s Investors Service and S&P Global Ratings.

The Michigan State University deal priced March 2 landing at 4.165%, a 195 bp spread. MMD currently evaluates the bonds at a 209 bp spread. The bonds had initially traded as tight as a 184 bp spread and as cheap as 211 bps. MSU carries Aa2 and AA ratings from Moody’s and S&P. Both deals were taxable.

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Both headed into a risk averse market with outflows and inflationary concerns magnified by worries over Russia’s invasion of Ukraine.

“Everyone should keep these bonds on their radar screen,” said Patrick Luby, senior municipal strategist at CreditSights. “They will be a good weathervane for when a risk on mentality arrives in the market. If they outperform 30-year bonds I would take that as a leading indicator of an increase” in investor willingness to take on risk.

“From the issuer's perspective, it sets a new benchmark for what's doable and for the market it introduces a couple large new bonds that the market can watch as indicators of market sentiment,” Luby said, adding that it's the UM deal that stands out the best indicator of investor sentiment given its size.

Luby attributes UM’s wider spread than MSU’s despite its higher rating to concessions needed given its size. Market turmoil also rose in between the pricings fueled by the Russian invasion of Ukraine. There's a limited universe of buyers who can look at a 100-year bond, like pension funds and life insurance companies, so a larger size is harder to digest.

Both deals settled at spreads wider than where outstanding 100-year bonds from universities had recently traded.

"These two deals have helped reprice that part of the market," Luby said. "For those investors for whom 100-year bonds make sense, they were able to pick up a high-grade credit at spreads much cheaper than where other high grade ultra-long bonds had been evaluated prior to the sale."

University of Minnesota is planning a $500 million century bond issue this spring and Claremont McKenna College sold $300 million earlier this year. that tapered off with the 2020 onset of the COVID-19 pandemic.

UM's deal also offered a $500 million 30-year tranche, added to the deal when orders proved sufficient, and $300 million tranche of taxable green-designated bonds planned from the outset. Both tranches of 30-year bonds paid a yield of 3.5%, a 115 bp spread to the comparable Treasury, compared to the 210 bp spread on the 100 year.

Repriced by the two century-bond deals, the taxable municipal bond indices got crushed and underperformed the UST and corporate indices, CreditSights said in a report Monday authored by Luby and John Ceffalio, senior municipal research analyst.

Both schools headed into the market after expensive legal settlements of sexual abuse scandals but analysts and traders said they didn't believe either paid a pricing penalty.

Given their long duration the concern is more focused on long-term credit quality, the prospects that the school will persevere over the long term, and how well its governance has managed crisis likes the abuse scandals and the COVID-19 pandemic.

Both deals were oversubscribed at original levels, school officials said. UM said its sale was the largest ever in the sector.

“Strong demand from investors, both in the U.S. and abroad, allowed the university to upsize the transaction beyond what was originally expected,” Chief Financial Officer Geoff Chatas said in a statement. The finance team had “targeted a significant audience of international investments” and was “able to generate more orders for bonds than were originally available” upsizing the deal to $2 billion.

The university board had approved up to $2 billion of new money but given market turmoil the university initially decided initially to offer just $1.5 billion.

Barclays was the lead underwriter and Loop Capital Markets was co-lead on the UM bonds. The blended rate for the century and 30-year bonds was 3.98%

The deal provides the university a great opportunity to prefund planned debt needs for capital projects at historically low interest rates for years to come, Chatas said.

MSU said its bond was 2.2 times oversubscribed. “This strategic investment in our future allows us to position the institution for continued research and academic excellence while being prudent stewards of our finances,” MSU Chief Financial Officer Lisa Frace said in a statement,

Bank of America Securities Inc. and Morgan Stanley were senior managers on the MSU deal.