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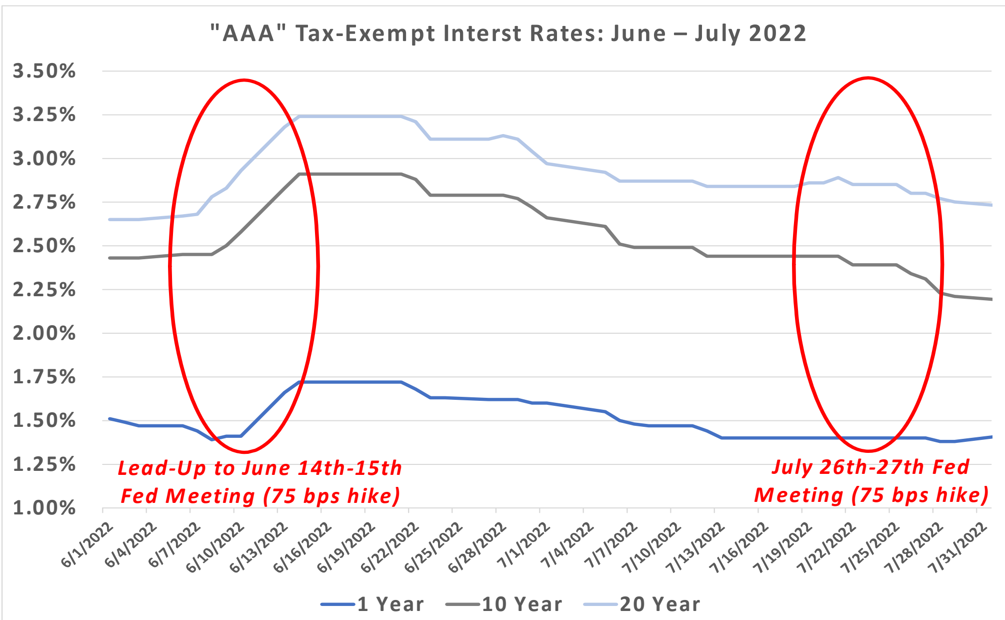
Rates on the Move: Another Historic Federal Reserve Rate Hike

Tax exempt interest rates, for the second time this year, saw a break in their upward momentum during July. As they did in the latter half of May, "AAA" General Obligation rates declined in July, sliding by an average of 16 basis points (bps) over the month's opening two weeks. Into the month's end, rates leveled off before falling an additional 20 bps for medium to long term maturities in July's closing days. Though the Federal Reserve again raised its target federal funds rate by 75 bps on July 27th, the same hike as in June, tax-exempt rates responded quite differently. Whereas rates climbed significantly leading up to the Fed's June announcement, rates plateaued at their newly lowered levels leading up to the July 27th decision. One possible cause for this discrepancy could be differing market expectations: while a 75 bps hike in June was the more aggressive of the market's two anticipated alternatives (50 bps versus 75 bps), a 75 bps hike in July was actually the more conservative potential Fed action given market discussion about a potential 100 bps hike.



However, one significant constant between these consecutive hikes is the Fed's messaging about inflation. In its July 27th statement, the Fed reiterated its "strong commitment to returning inflation to its 2 percent objective" as well as its expectation that "ongoing increases in the target [Federal Funds] range will be appropriate." Fed Chairman Powell cited inflation as a leading indicator for Fed decision-making, but also noted the continued strength of the U.S. labor market and its need to "soften" before price levels can come down to a sustainable level over the long term. This month's 75 bps bump comes after a series of increasingly aggressive Fed rate hikes: 25 bps in March, 50 bps in May, and 75 bps in June. The Fed's quantitative tightening policy also remains in place, meaning the Fed is selling its own Treasury and debt securities as an additional tool to put upward pressure on market interest rates. The Fed will meet again on September 20th-21st.

Recent CMA Client Sale Results

Issuer	Issue Type	Par Amount	Sale Date	Term	Rate	Purchaser
Long Beach City (Baa2)	BAN	$ 4,033,935	28-July	6 mos.	3.11%	JP Morgan Chase Bank
Harrison Fire District #2 (Aa3)	Bonds	$ 8,380,000	26-July	24 yrs.	3.61%	Roosevelt & Cross, Inc.
Wappingers CSD (A2)	TAN	$ 4,500,000	21-July	3 mos.	2.13%	Piper Sandler & Co.
Port Washington UFSD (Aa2)	Bonds	$ 59,520,000	21-July	15 yrs.	2.96%	Jefferies LLC
Wallkill Town (AA)	BAN	$ 24,145,100	19-July	1 yr.	2.04%	JP Morgan Securities, LLC
Clarence Town (Aa1)	Bonds	$ 22,645,000	13-July	29 yrs.	3.69%	Roosevelt & Cross, Inc.
Bethlehem CSD (AA)	BAN	$ 3,255,000	6-July	12 mos.	2.66%	Piper Sandler & Co.

Change to Lease Accounting Standards

New lease accounting standards announced by the Government Accounting Standards Board ("GASB") require the adoption of GASB 87 for all fiscal years beginning after June 15, 2021. As such, school districts will likely have new reporting requirements under GASB 87 associated with FYE 6/30/2022 audits.

GASB 87 no longer makes a distinction between operating and capital leases and as a result, previously unreported operating leases may now need to be added to financial statements. To calculate the lease liability, GASB 87 looks for the interest rate implicit within the lease. However, the implicit rate might not be readily available or determined in lease documents, particularly in the case of operating leases. In such instances, GASB 87 directs use of an estimated incremental borrowing rate or the estimated interest rate that the Lessee would have been charged for borrowing the lease payment amounts during the lease term.

Use of Municipal Market Data (MMD) tax exempt interest rate scales may be a good source of information for estimating interest rates for this purpose as MMD rates are published daily, organized by credit rating and term and available for dates in the past. Lessees will want to consult with their accountants regarding application of GASB 87 and use of historical MMD, with which CMA is happy to assist its clients.

Increased Demand for Tax Exempt ETFs ... A Positive Sign for Municipal Issuers

The equity and bond markets have experienced a very volatile, three-month period due to significant increases in inflation which exceeded 9% in July. The high inflation has driven the Federal Reserve to aggressively increase interest rates over the past few months to attempt to slow staggering inflation growth. These two factors have driven a shift in investor demand away from equities and toward municipal tax-exempt debt. The Municipal Securities Rulemaking Board issued its mid-year report on July 1, 2022 and noted that demand for tax-exempt exchange traded funds (ETFs) increased more than 400% in the first half of 2022. Municipal debt issuance is an important component of the tax-exempt ETFs market. The increased demand for tax-exempt ETFs should be beneficial for municipalities issuing debt during the balance of 2022. It also makes mutual fund managers a more important investor base for municipalities. Mutual Funds, ETFs, and Closed-End Funds own 26% of the total municipal bond market at the end of Q1 2022, according to the Trends in Municipal Securities Ownership report issued by the Municipal Securities Rulemaking Board in June 2022. ETF portfolio managers are becoming more important target investors for future municipal debt issuances.

MMD General Obligation Interest Rates

Tax exempt interest rates stand between 25-50 bps below their levels from one month ago across ratings and terms. However, they are still well above their levels from one year ago when 1-year rates were at or near single digits and rates for longer term debt were in the 1-2% range. In fact, rates are about 150 bps higher, on average, for short term maturities and about 175 bps higher, on average, for longer term maturities today than they were one year ago. The weekly average 30-day forward supply of bonds has fallen from last month and is consistent with levels from one year ago. Weekly deal volume in July's closing week is significantly lower than it was to close June, and is also less than levels from this time last year.

	Today - August 1, 2022					1 Month Ago - July 1, 2022					1 Year Ago - August 2, 2021				
Term	Aaa	Aa	Insured	A	Baa	Aaa	Aa	Insured	A	Baa	Aaa	Aa	Insured	A	Baa
1 yr.	1.41%	1.46%	1.59%	1.60%	1.93%	1.60%	1.73%	1.86%	1.87%	2.12%	0.05%	0.07%	0.11%	0.12%	0.30%
5	1.79	1.92	2.04	2.09	2.44	2.18	2.36	2.48	2.53	2.83	0.36	0.41	0.44	0.49	0.74
10	2.19	2.41	2.54	2.61	3.08	2.66	2.93	3.06	3.13	3.55	0.82	0.95	1.00	1.07	1.45
15	2.51	2.82	2.92	3.03	3.42	2.84	3.15	3.25	3.36	3.75	1.02	1.17	1.20	1.32	1.65
20	2.73	3.08	3.19	3.29	3.68	2.97	3.32	3.43	3.53	3.92	1.19	1.34	1.38	1.49	1.82

Weekly Deal Volume (incl. Bonds and Notes)		
$2.887 billion	$19.165 billion	$9.046 billion
30-Day Forward Visible Supply (Bonds only)		
$9.520 billion	$11.304 billion	$9.314 billion