



TFA

Monthly Newsletter

June 2023

IN THE NEWS

Why Tribes Should Explore Municipal Debt

By Braxton Sato

While less talked about in the news than the \$31 trillion market for U.S. Federal Government Debt (it is once again “debt ceiling” negotiation season in Congress), the nearly \$4 trillion municipal securities market plays a very important role in American public life. Over 44,000 States, counties, cities, towns, and school districts across the country have issued almost 1 million different municipal bonds to fund a wide variety of infrastructure, economic development, and other governmental initiatives. These bonds are secured by future governmental revenues as a source of repayment, usually taxes. And while municipal bonds come in a variety of maturities, typically these are long-dated securities repaid slowly over a long period of time. This allows large infrastructure projects with long useful lives to be paid for over a similarly long time-horizon. Borrowing costs for municipal issuers are typically lower than other available alternatives, controlling

for credit quality, because interest earned on municipal securities is almost always exempt from federal income taxes, and often from state income taxes as well.

Tribes are relatively new to the municipal finance space, as they were not even eligible to issue tax exempt debt until the Indian Government Tribal Tax Act of 1982. Overall, Tribes represent a very small portion (less than 1%) of the overall municipal bond market. And this share is shrinking, even though Tribal governments manage more land than all but three States, and have collective enrollment greater than the population of all but 10 States. Only two Tribal municipal bonds were issued between 2020 and 2021 (total issuance of \$40 million), and issuance has significantly declined after the 2008 financial crisis in both number of issuances and dollar volume. What is driving Tribes’ retreat from accessing the municipal finance market?

Alaska Native Organizations Form Teaching Partnership to Bring Culture and Technology Together
5/5/23 – nativebusinessmag.com

U.S. Department of Commerce Invests \$1.9 Million in American Rescue Plan Funds to Establish Tribal Health Center in Utah
5/6/23 – nativebusinessmag.com

EPA Awards Grants to Virginia Indian Tribes for Sustainable Materials Management
5/11/23 – nativebusinessmag.com

Puyallup Tribe and Kenmore Air Announce Partnership To Bring Seaplane Operations To Tribal Lands
5/18/23 – nativebusinessmag.com

California Governor Signs Bill Reinstating Cardroom Moratorium
5/23/23 – playusa.com

Native News Weekly (May 28, 2023): D.C. Briefs
5/28/23 – nativenewsonline.net

History Made as First Navajo Appointed U.S. Federal Judge in California
5/31/23 – nativenewsonline.net

(continued from Page 1)

Years	Number of Tribal Bonds Issued	Total Amount Issued (millions)
1992-1997	59	\$ 756
1997-2001	93	\$ 1,134
2002-2006	131	\$ 1,196
2007-2011	48	\$ 1,385
2012-2016	25	\$ 670
2017-2021	23	\$ 232

Native American Governments' Borrowing Costs: Evidence from Municipal Bond Markets" Loftus, McCoy and Zhang (2022)

For the past several years, Tribal Governments have enjoyed access to very low-cost financing, in many cases utilizing loans secured by gaming cash flow to fund governmental or other economic development initiatives. From 2009 through 2016, 3-month LIBOR was below 1%. During this same period, the success of Tribal casinos allowed many tribes to rapidly deleverage and pay down casino related debt. This made bank debt secured by casino assets extremely attractive, with variable rate pricing margins falling as low as 75 basis points, putting all-in borrowing costs between 2% and 5% depending on the leverage of the borrower. These rates were often lower than tribal municipal markets at the time. Per a [July 2022 research paper](#), studying municipal borrowing costs for Tribes, the average tribal municipal yield was 5.77% between 1992 and 2021.

Tipping the scales further in favor of utilizing bank debt was the "premium" paid by tribal issuers in the municipal markets. In the same study, the authors observed that the average non-tribal municipal yield was 2.88% - Tribes were paying nearly double on municipal debt even after controlling for factors such as credit quality, size, maturity, amortization, and taxability. The study did not speculate as to what market factors drove this premium, but we speculate it is due to some of the complexities of Indian Law shrinking the pool of investors willing to understand the space.

Lastly, Tribes are subject to regulations that State and Local governments are not. The Tax Reform Act of 1984 imposed the restriction that tax-exempt municipal debt issued by Tribes must be for the purpose of "Essential Government Functions." This means Tribes are restricted from issuing private activity bonds for projects like airports, hospitals and rental housing. The Tribal Economic Development Bond ("TED B") program gave Tribes more flexibility on permitted uses of funds, but this \$2 billion allocation ran out years ago.

Given the confluence of the tribal yield premium, restrictions on uses, inflexibility of the bond structure, high legal

and underwriting costs, it is not a surprise that most Tribes opt to go with short term bank financing to fund long term infrastructure and tribal projects – or opt not to pursue large infrastructure projects at all because the high debt service requirements have too big an impact on government budgets.

However, the rising interest rate environment is making municipal bond debt for governmental projects more compelling than bank debt. With underlying rates rising and a tightening credit environment, the relative benefit of issuing tax exempt debt has improved significantly. When the cost of funds was 1% (or less), the tax-exempt rate of 0.65% wasn't that attractive – saving just 0.35% annually. At 5%, a tax-exempt rate of 3.25% creates a significant benefit – saving closer to 1.75% annually. As rates move higher, utilizing tax exempt rates becomes more meaningful.

Better rate economics combined with lower amortization requirements for municipal bond financing should encourage Tribes to analyze the municipal option when thinking about how to pay for a government project. TFA is always happy to discuss creative ways to fund your Tribe's projects – please reach out to us to learn more.

TFA

201 Continental Boulevard
Suite 110
El Segundo, CA 90245
tfacp.com

KRISTI JACKSON
CHAIRMAN
310.341.2335
kjackson@tfacp.com

WILLIAM NEWBY
PRESIDENT
310.341.2796
wnewby@tfacp.com

DAVID HOWARD
CEO
310.341.2795
dhoward@tfacp.com

WILLIAM CRADER, CFA
MANAGING DIRECTOR
310.341.2336
wcrader@tfacp.com

FOLLOW TFA ON:



BRAXTON SATO
VICE PRESIDENT
310.341.2339
bsato@tfacp.com