Aquila Churchill Tax-Free Fund of Kentucky

Podcast Transcript January, 2021

This is Candace Roane, Director of Marketing for Aquila Group of Funds. Today is January 19th and I'm joined by Royden Durham, Lead Portfolio Manager of Aquila Churchill Tax-Free Fund of Kentucky. Welcome to the podcast, Royden.

Royden Durham:
Hi, Candace.

Candace Roane:
Now that we know that the Democratic Party will control the executive and legislative branches for at least the next two years, can you give us your thoughts on policy changes that might impact the muni market?

Royden Durham:
Sure. The newly elected Democrat majority has a huge wish list of items. What does pass could be another story. If we take the Biden administration at their word, a roll back of the Tax Cuts and Jobs Act of 2017 would lead to more tax exempt refundings, which were abolished under that bill. An increase in Federal taxes would feed demand for more tax-free income. Issuance would likely increase with spending for infrastructure projects like fixing bridges, plus funding, let's say, the new Green Deal projects. From what we know at this point, social and environmental impact language will be mandated by the SEC and FINRA in all new municipal, preliminary official statements which may create a completely new area of law, I think.

Candace Roane:
You mentioned how the Tax Cuts and Jobs Act prohibited tax exempt refundings which is one reason the market has seen an increase in taxable issuance. Would you say that taxable munis are gaining popularity with investors and with issuers, and do you expect to see that trend continue?

Royden Durham:
There has been a huge demand by institutional investors for taxable municipals, partially due to the nature of stable credits with specific revenue streams attached to the muni debt. If you buy a corporate bond, the debt is tied to the general debt of the corporation in most instances today. In the past, that may have been a first mortgage guarantee. So a debt stream tied to a water revenue bond project, in a period of economic and political stress, relieves investors' credit worries to a degree. This has propelled demand and lured new buyers like foreign insurance companies into the buyer's pool. If you look at municipal credits over time, they tend to be more stable than corporate credits as well. Still, only about 16% of Kentucky issuance in 2020 was taxable municipals. If rates trend higher, it is possible that demand for taxable munis will wane since the borrowing cost differential would widen and favor the issuance of tax-free by the issuer to get the lowest possible lending cost. Rates now are so low, it makes little economic difference. We are seeing taxable issuance right now because you can refund the tax exempt issue paying 3% with taxable deal at just 1.6%.

Candace Roane:
Let's talk about defaults. I know we covered this a little bit on our last podcast, but I think it's worth discussing again. We have a new administration coming in. They're committed to focusing on implementing measures to control the pandemic. Do you think that we'll see more stress on muni sectors because of that and potential defaults in Kentucky?

Royden Durham:
Purely from a local point of view, the only sector I'm worried about is the arena stadium debt. Basically in Kentucky, there are only three Rupp, Yum!, and the Louisville FC Soccer Club that have issued public debt. Rupp about four months ago did a Lexington financing to tide it over expected revenue shortfalls for the next three to four years, so that's not a concern. There has been little publicly written about Yum!, and Churchill [the Fund] does not own any. Ultimately the city of Louisville was on the hook for both the FC's Soccer Club and Yum!. The rating agencies continue to rate Louisville a strong AA. The Fund does not own any Louisville city debt, other than parking garages, which

are tied to that specific income stream. In a local periodical, a local financial analyst said that Yum! Arena branding fees from Yum! plus reserves and 2019 TIF (tax incremental financing) taxes have the arena in good financial position currently.

Another concern might be airports in some locales are under duress as well. Louisville and Kenton County are doing well since cargo enplanements are making up the difference versus passengers. The only Lexington airport bonds we hold are escrowed. I've seen little information on Lexington, but feel it probably is being shored up by Federal COVID money.

Kentucky, in general, is 5.4% ahead of budget overall as of December 31st, 2020. This is based on fiscal year end of June 30th. Save November 2020, Kentucky general revenues has exceeded budget every month. Finance attributes our success to logistics and taxes on online sales.

Candace Roane:
Thank you. That's great sector information and economic information from the State. Let's close with your outlook for the local muni market and the national muni market over the next few months. Where do you see rates going from here?

Royden Durham:
Well, the legislature in session currently appears to be putting together another one-year (it's normally a two-year) budget, that will be very frugal. So not seeing in the cards much new issuance, other than on IT for the unemployment office that has had a tough time processing COVID-related unemployment payments. So tight Kentucky supply is a probable outcome. By the way, issuance in Kentucky rose 2.3% in 2020 versus an increase nationally of 11.2%. This makes my point of frugal Frankfort budget.

Rates, I believe, will trend slightly higher over the year on the 10-year treasury which is currently at a 109. Since everyone has predicted higher rates for the past eight years, this could be the year, since we seem to be coming off the generational low of a half a percent on the 10-year treasury setback on August 4, 2020. If the new administration shuts down fracking, passes a $5 trillion COVID and Green New Deal spending package, I would envision substantially higher everything.

Also, I'm watching the situation with Governor Beshear closely. Currently the Kentucky house is forming a committee to consider impeachment for violating the constitution with his COVID restrictions.

Candace Roane:
Sounds like there's a lot to watch in Kentucky. Thank you for joining me today, Royden. As always, we appreciate your valuable muni insight.

Royden Durham:
Thank you, Candace.

Disclosure:

Thank you for listening to this podcast. Before investing in the Fund, carefully read about and consider the investment objectives, risks, charges, expenses and other information found in the Fund perspective. The prospectus is available from your financial advisor when you visit www.aquilafunds.com or call (800) 437-1020.

Information regarding holdings is subject to change and is not necessarily a representative of the entire portfolio.

Mutual fund investing involves risk. Loss of principle is possible. Investments in bonds may decline in value due to rising interest rates, a real or perceived the chronic decline in credit quality of the issuer, borrower, counterparty or collateral, adverse tax or legislative changes, court decisions, market or economic conditions. Fund performance could be more volatile than that of funds with greater geographic diversification. The Fund seeks to provide a high level of income exempt from state and federal income tax as is consistent with capital preservation. Past Performance does not guarantee future results.

For certain investors, some dividends may be subject to federal and state income taxes, including the alternative minimum tax referred to as A and T. Please consult your tax professional. Independent rating services such as Standard & Poor's, Moody's and Fitch assign ratings which *generally range from AAA highest to D lowest, to indicate the credit worthiness of underlying bonds in the portfolio. Where the independent rating services differ in the rating fee assigned to an issue or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Pre-refunded or escrowed bonds are issued for the purpose of retiring or regaining an outstanding bond issue at a specific call date. Until the call date, the proceeds of the bond issuance are typically placed in a trust and invested in US treasury bonds or state and local government securities.*

Modified and effective duration both measure the value of a security in response to a change in interest rates. Effective duration also takes into account the effect of embedded options. The weighted average life, also referred to as weighted average maturity, is a reflection of the quickness with which the principle of an issue is expected to be paid. A credit spread is the difference in yield between two bonds of similar maturity, but different credit quality. Taxable equivalent yield is the return that is required on a taxable investment to make it equal to the return on a tax exempt investment. For certain investors, net investment income tax, known as NIIT may apply. NIIT is a 3.8% tax established by the patient protection and affordable care act that applies to the lesser of, the net investment income, or a taxpayer's modified adjusted gross income in excess of an applicable threshold amount. The acronym PERS, P-E-R-S, stands for public employee retirement system. The acronym PERA, P-E-R-A, stands for public employees' retirement association.

CARES Act Stands for Coronavirus Aid, Relief, and Economic Security Act.

Yield refers to the earnings generated and realized on an investment over a specific period of time. Yield is expressed as a percentage based on the invested amount, current market value, or face value of the security, and includes the interest earned or dividends received from holding a particular security.

Yield ratio represents the comparison of the expected yield of one bond to the expected yield of another. A yield ratio is important when deciding whether to invest in one bond or another. Generally, the higher yield is considered better.