Aquila Tax-Free Fund For Utah

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 JT Thompson, lead portfolio manager of Aquila Tax-Free Fund for Utah. Welcome to the podcast, JT.

JT Thompson:
Welcome. Thanks.

Candace Roane:
JT, now that we know the Democratic Party will control the executive and legislative branches for at least the next two years, what are your thoughts on policy changes that might impact the muni market?

JT Thompson:
There's a few things. What has been said is they want to reverse the Trump tax cuts. So that could mean tax increases. Biden has mentioned that he wants the wealthiest 1% to pay their fair share. So tax increases are probably in the mix. On the muni side, they're looking at maybe reinstating the ability to issue tax-exempt debt, to refinance existing tax-exempt debt. That would be helpful for a lot of cities in refinancing their debt at these low interest rates. And they've also talked about infrastructure spending.

So, there is a little bit of everything talked about. The $1.9 trillion COVID-19 relief bill has billions of dollars to help cities and states and bail them out of some of their debt. Utah, they have a constitutional amendment, you have to have a balanced budget. So we haven't had any deficit spending here and our budgets are well within reach. In fact, we have rainy day funds. And as far as the infrastructure, Utah has been very careful in spending, but has been spending on infrastructure. In 2020, there was $800 million in municipal bonds issued for both moving the prison out towards the airport and the widening of interstate 15. So, in a measured pace, Utah has been, over the years, spending on infrastructure. There could be some other projects available but has to be within the budget for the State of Utah.

Candace Roane:
You mentioned how the Tax Cuts and Jobs Act prohibited, tax exempt refundings, which we know is one reason why we've seen an increase in taxable issuance over the last couple of years. Would you say that taxable muni's are gaining popularity in general with investors and issuers? And do you expect to see that trend continue?

JT Thompson:
The low treasury rate has enabled taxable municipal bonds to be issued to refinance tax-exempt bonds. What has happened over the last few years, municipal finance is starting to be understood worldwide and exempt rate. Worldwide they've been buying tax exempt bonds, but with taxable municipals being spread over treasuries and the credit quality being there, we have seen an enormous amount of demand from overseas investors. To the point where a lot of the official statements do have qualification opinions by attorneys of what countries these bonds have been registered to sell. In Europe, you have seven European countries that their 10-year bond is 30 basis points, or negative, in interest rates. When you see a taxable muni with probably the same default rate as most governments, there is a way to pick up extra yield and that's their popularity. But even before they did away with a tax exempt refunding, tax exempt bonds, municipal finance has been popular worldwide.

Candace Roane:
Let's talk about defaults. We discussed defaults on the last podcast, but I think it's worth discussing again now that we have a new administration committed to focusing heavily on implementing measures across the country to control this pandemic. Do you expect to see any more stress on certain muni sectors and potentially defaults in Utah and nationally?

JT Thompson:
Not in Utah, nationally again with the COVID relief of helping cities and states out, we're probably not going to see a lot of defaults there. In municipal finance, for the most part, municipal bonds securitize a revenue stream. In general obligation bonds, it's the taxing power of the

issuer for essential services like electric, water, sewer. It is the ability to raise rates to cover debt service. The area, the sector that has the most default rate is what we call conduit financing. For example, hospitals, nursing homes, those type of bonds where if the revenue is in generated, then the revenue isn't there to pay off the debt service. That's where we see the highest amount of defaults. That will continue, there could be some convention centers which would be a conduit financing or even maybe some hotels that were issued with tax exempt debt having problems because of the revenues aren't there because of COVID. We try to stay away from conduit, financing, and stick with essential services and general obligation bonds.

Candace Roane:
Thanks, JT, building on all of that sector information, let's close with your outlook for the local and the national muni market over the next few months. Where do you think yields might go from here?

JT Thompson:
Well, locally, Utah's economy is in good shape. They expect at least a 1% increase in 2021, which is great considering the pandemic. In 2022, they see maybe a little slight off from revenue growth there mainly because they expect construction spending in 2021 to be a lot lower than previously. And that's mainly because a lot of the projects are being finished, the major projects. So, and the legislature, they're looking at that and using those estimates in their budgets, but Utah is still in decent shape. I don't see any real concerns or headwinds for the Utah economy.

Interest rates, going forward, the one to seven year range on tax exempt municipal bonds has gotten to so low that you're starting to see resistance at that level. And it's harder and harder on new issue deals to see those bonds being sold. So, going forward, maybe a little bit of the flattening of the municipal yield curve in the short end to get rates up a little bit higher to bring in buyers, but just a little bit of resistance there. I think COVID and the spending by the Fed and the buying by the Fed will keep rates within range bound, probably between the 10 year between 75 basis points and maybe one and a quarter percent will be range-bound until the economy really starts to pick up.

Candace Roane:
This is great info. Thank you for joining me today, JT. We always enjoy your valuable muni insight.

JT Thompson:
Thank you.

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.

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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.