



Portfolio Management

By Jim Reber, ICBA Securities

Echoes of the ARRA

Decade-old legislation could affect bond portfolios this year.

Satchel Paige, the baseball Hall of Famer and clubhouse philosopher, once advised: “Don’t look back. Something might be gaining on you.” As 2019 arrives, this could apply to certain securities lurking in your investment portfolio.

For the most part, community bankers have put the turmoil surrounding the Great Recession firmly in their rear-view mirrors. The industry reported record earnings last year, and many of the metrics that determine success for depository institutions are pointing to a robust 2019.

However, it’s been well documented that available liquidity has dwindled. The good news is, a portion of your investments may be converting itself to cash in the very near future. So, it may

be helpful to review what caused these to land in your bond portfolio in the first place.

The main “spendulus” bill to pull the U.S. economy out of its deep recession was the American Recovery and Reinvestment Act (ARRA) of 2009. It contained some provisions that affected how community banks manage investments, especially their municipal bonds. The law created some new tax-affected investments, expanded the scope of some existing bonds and made others more beneficial for community banks to own.

One new product was the line of taxable munis known as Build America Bonds (BABs). These securities financed infrastructure projects and were attractive to borrowers because they were subsidized by the U.S. Treasury for 35 percent of the coupon. Buyers liked them too, because BABs were high quality, usually were general



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obligations, and since they were only eligible to be issued in 2009 and 2010 when banks had little or no earnings, they were an attractive alternative to tax-free bonds.

There was other language that applied to only 2009 and 2010 issues. The size limit on Bank-Qualified (BQ) bonds was raised from \$10 million to \$30 million, and in spite of ICBA's best efforts, the provision expired in December 2010. Tax-free bonds that were not BQ could be treated as such by a community bank if a) the issues were "new money" and b) the bonds in aggregate were less than 2 percent of the bank's total assets. These are known as "2 Percent Rule Bonds." Also, 2009 and 2010 issues were not subject to the Alternative Minimum Tax (AMT) if they were not refinancings of older outstanding deals.

Advance notice

What do these divergent municipal bonds have in common? Most of the longer maturities in each case came to market with a 10-year call date. And those dates have arrived, or will soon. So, if you haven't already noticed, you may experience a flood of calls this year or next.

Economically, the issuers of these seasoned bonds probably have good reason to call them. Not only are longer (five years and up) rates lower than they were in 2009–2010, but the ever-present demand from the retail sector keeps market yields on the short end depressed. So many of the BABs, BQs and 2 Percent bonds are actually in-the-money to be called as soon as the call date gets here.

Get out in front

My advice is to get a current projected cash flow ladder of all of your bonds, including municipals. Your favorite broker should be able to provide this information in the "base case," and

Education on Tap



Convention workshops

ICBA Securities and its exclusive broker, Vining Sparks, will present four Learning Labs at ICBA LIVE 2019, March 18–22. Visit icba.org/convention and click on "Education Sessions" for further details.

Webinar series continues

ICBA Securities and Vining Sparks have announced the next segment of their 2019 webinar series Community Banking Matters for March 26 at 10 a.m. CST. Dennis Porcaro and Justin Sparks of Vining Sparks will discuss "Municipal Market Update: Investment Strategies and Credit." Free CPE is available. To register, visit viningsparks.com

shocked at +/- 400 basis points. If you have some stacked up to be called in the next two years, you have options.

Most community banks at this point of the economic cycle could use some liquidity. However, given the relatively low yields that persist for shorter munis, it's possible (if not likely) to make the math work on an extension swap. And even if you'd be selling something at a gain, which often makes the economics of a muni swap more challenging, remember that any BABs that you would sell are taxable to start with, which helps the math.

So why don't you take a look back into your muni holdings, focusing on those that have born-on dates in 2009 and 2010. Those call dates may be gaining on you. ■



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