LOOKING BACK AND MOVING FORWARD IN PUBLIC FINANCE

Dennis Hunt, Head of Stephens Public Finance, reflects on 2021 and reports what's on the horizon for 2022

Interest rates and legislative developments proved impactful to Arkansas school districts in 2021. How have they affected the public finance landscape, and what can leaders expect for the future? Dennis Hunt, Executive Vice President and Head of Stephens Public Finance, offers his insights in this end-of-the-year Q&A.

Looking back on 2021, what do you think has been the most consequential development in public finance for Arkansas schools?

Arkansas schools experienced significant increases in interest rates during 2021. All across the yield curve, rates increased substantially. In certain maturities, interest rates have more than doubled since the beginning of the year.

What impact did these interest rate increases have on school districts' financial flexibility?

Higher interest rates have limited the ability of districts to refund outstanding bond issues with higher interest rates in order to realize a reduction in debt service expenses. This is reflected in the number of transactions completed for school districts in 2021. During 2020 there were 218 bond issues completed for school districts. In 2021, mainly due to an increasing interest rate environment, only 109 or half as many school bond issues were completed.

Although interest rates have increased significantly, they are still at historic lows. This may account for many of the 109 school bond issues in 2021 being much larger than in the past. For example, our client, the Little Rock School District plans to issue the largest school bond issue ever completed in the state of Arkansas — approximately $315 million. Despite far fewer school bond transactions being issued in 2021, the aggregate par amount of bonds that will be issued will exceed the 2020 par amount by over 16 percent.

Looking ahead to next year, while you cannot exactly predict exact interest rates, could you provide some context for a prognostication. What are the factors that are going to affect interest rates in 2022?

While I am not able to predict interest rates in the distant future, if the inflationary trends that we are currently experiencing are more than transitory, meaning that they will be around for two or three years, I believe interest rates will continue to go higher. Interest rates are typically correlated to the rate of inflation. So, the higher the rate of inflation, the higher interest rates will trend.

However, if inflation we are currently experiencing is attributable to the pandemic and related supply chain issues, and those are resolved by the end of the first quarter of 2022, I believe we may observe a period of stabilization and possibly even reductions in interest rates from where they are today.

Can anything be done to slow down inflation?

Yes. Unfortunately for school districts, the Federal Reserve can elect to increase short-term interest rates or what is commonly known as the Fed Fund Rate. While this will slow down the economy and resulting inflation, it also translates to higher interest rates for school districts. At this point in time, the Federal Reserve has taken a wait-and-see approach relating to raising the Fed Fund Rate until it is determined if the inflation we are currently experiencing is transitory or longer term.

In 2021, state legislation was passed that put further limits on when Arkansas school districts can schedule elections and added requirements to them. Are there other areas of legislation you can see that will impact school districts' financing flexibility?

While I am not aware of any additional state legislation, probably at the federal level adopting legislation to restore the ability for school districts to issue tax-exempt advance refunding bonds issues is the most impactful. The ability of school districts to use this effective financing tool was eliminated with the 2017 Tax Reform Act. Restoration of this financing option would undoubtedly provide school districts with greater financing flexibility and potentially result in debt services saving for school districts.

Is there any prospect of tax-exempt advance refundings returning?

I am hopeful but not optimistic. While there have been concerted efforts to restore tax-exempt advance refunding bonds, those efforts have not yet been successful. Although a provision to restore the financing technique was originally included in the Build Back Better legislation due significant give and take between the House and the Senate, it is currently no longer included.

How would you advise school districts to navigate these headwinds of inflation and flexibility-limiting legislation?

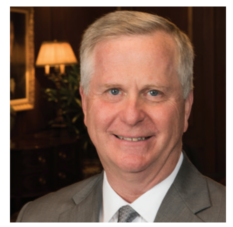
With rising inflation and interest rates combined with new election laws, I believe school districts must work closely with their financial advisor — perhaps more closely than ever — to effectively determine timing and their total cost of capital financing. Not only are school district going to be impacted by higher interest rates, which will impact their cost of financing, they are also going to be affected by the inflationary impacts on the cost of construction.

As we turn the page on the calendar year, what kinds of activities and discussions are Stephens engaging with clients?

Stephens consistently strives to keep our clients up to date and informed of the changing school financing and regulatory landscape. With relevant information for our clients, we work closely with them on election timing, market trends, millage capacity, capital financing, voter education, as well as regulatory issues at the state and federal levels. We inform and engage our clients to make the capital financing process as easy as possible so they can focus on their primary responsibility- education.

We have explored relatively short-term factors in the public finance market relevant to Arkansas school district leaders. Looking at the bigger picture, what makes Stephens Public Finance such a good partner for districts' long-term success?

At Stephens we focus on being a trusted advisor to our clients, specifically school district leaders, with the perspective of a long-term relationship. Our goal is to be a valuable resource for our clients, regardless of the issue. We are there to support school district leaders well beyond facilitating a bond issue.



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