NAHEFFA
National Association of
Health and Educational
Facilities Finance Authorities

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Supporting ACCESS

Current Economic / Investment Thoughts

by Graystone Consulting

Although 1Q 2018 earnings season was excellent, not everything on the economic front is sunshine and roses here in the US. We have a number of long-term, structural problems not the least of which is a large federal government debt and interest cost problem that eventually will need to be addressed. To gain greater senses of the magnitude of the problem consider the following facts courtesy of the US Treasury Department:

(1) In 2000 total US government debt was $6 trillion and the cost to service that debt was approximately $360 billion annually. That translates to an average annual debt interest rate cost of approximately 6.0%.

(2) Today, total US government debt is now $21 trillion and the average cost to service that debt is approximately $450 billion (i.e., an approximate 2.2% average annual debt interest rate cost). So, in just under twenty years, our nation's debt has ballooned 300%+ and the cost to service that debt has only risen by 25%. That does not sound that bad except the problem remains – what happens if interest rates rise and the cost of that debt increases - how are we going to pay for it?

We are not sure how to answer that question. At a time when we should be paying down the debt given that economic growth has been reasonably strong we are figuring out how to cut taxes and spend additional money on infrastructure – both of which will almost assuredly lead to wider deficits and a greater future debt burden. Yes, something has to give. And if interest rates really head higher the cost of that debt burden will rise significantly and potentially crowd out spending for other necessary programs. That is when the tough choices will have to be made. As for will interest rates head higher? We got a partial answer to that question in May. Until the recent concerns about Italian politics and Eurozone unity it sure seemed as if US interest rates were heading higher. Recent signs also point to rising inflation percolating just beyond our view – rising wages, an accelerating consumer price index (CPI), and rising energy prices leave little doubt in our minds that if nothing else, inflation is likely to emerge and drive interest rates higher eventually. The "Italian Crisis" just put a lid on things for a while longer. The problem has not gone away – nor will it anytime soon.

Given this and other significant fundamental problems plaguing the US economy coupled with stretched equity market valuations, narrow credit spreads, and tighter monetary conditions ahead we are choosing to stay conservative for a while longer. No, there will not be any immediate solutions to these or any of the other fundamental problems facing the US (i.e., large trade deficits, rising national healthcare

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Future NAHEFFA Conferences

September 12-14, 2018
Denver, CO
Magnolia Hotel

Spring 2019
Austin, Texas

In This Issue...

NAHEFFA President's Message

by Harry Huntley, Executive Director

South Carolina Jobs-Economic Development Authority

Harry Huntley

It is an honor to have the opportunity to serve as president of NAHEFFA for the next two years. This is truly a member driven organization with active and dedicated participation by everyone. My first NAHEFFA meeting was in the fall of 2009 in Chicago. My lasting memory is Pam Lenane and Paula Drummond acting so excited to meet me, until I figured what they really wanted was for me to host a meeting in Charleston. I gladly obliged and NAHEFFA had its 2011 Spring Conference in the Holy City. From the carriage rides to Sam Howell's history lesson and the incredible Charleston cuisine, everyone had a great time. Yes, I am a nostalgic guy.

I am also grateful for the tremendous leadership that Donna Murr showed during her term as president. We knew there was a possibility that private activity bonds would come under attack, and Donna took action. She called a meeting of the Advocacy Committee at the IFA office prior to the 2016 Fall Conference in Chicago. Along with Martin Walke, they laid out a plan to hire ML Strategies well before any new tax legislation was introduced. She knew this was a budget-busting proposition and encouraged as many members as possible to contribute to the cause. Chuck Samuels, Neal Martin and Alex Hecht did an incredible job keeping us informed and setting up meetings with our delegations in Washington. Then the bombshell dropped on November 2. Chuck Samuels had just finished his morning presentation at the JEDA Bond Summit in Charleston when the emails started coming. Black Thursday for everyone in our world.

Thanks to the efforts of so many NAHEFFA members leading up to this, we had laid the groundwork for a successful campaign to save our hides. Many of our members descended on Washington in every way imaginable. In seven weeks, the battle was over when President Trump signed the Tax Cuts and Jobs Act Bill. Some other organizations try to claim credit for the victory, but none did more per member than NAHEFFA. We truly fought well above our weight class.

A very wise man told me years ago that change is certain – just like death and taxes. Nothing stays the same forever. Our personal lives change, as do our business lives. My daughter recently graduated college and is moving to Austin. My middle son is getting married in August. My three granddaughters are growing up too fast. I don't hit the golf ball as far as I used to (just had to throw that in). Valuable members of NAHEFFA are retiring. Why should I think that 535 members of Congress are going to leave things as they are? We should not let our guards down. We should all continue nurturing relationships with our Washington delegations. Start with an email about recent projects in their districts. Dennis Reilly has done a wonderful job communicating this to his delegation. Get to know the legislative aides in your congressional offices. Start with the soft sell now and we will all be ready when the next battle comes. Thanks to the efforts of Chuck, ML Strategies, Donna, Martin and everyone else working for our cause, NAHEFFA is on a roll. Let's keep it going.

I am looking forward to our 2018 Fall Conference in Denver, September 11-14, co-hosted by the Colorado Health Facilities Authority and the Colorado Educational and Cultural Facilities Authority. I hope to see everyone there and encourage you to spend some extra time in the area. People in Colorado live outdoors and there are plenty of things to do just a short drive from Denver. Rocky Mountain National Park is just a short drive north and is a hiker and nature lover's paradise. The crowds will be gone after Labor Day, the elk will be everywhere and the fishing will be terrific. The town of Estes Park is the eastern entrance and there are plenty of places to stay. My favorite is the Swiftcurrent Lodge, which is on the Big Thompson River next to the park. Start planning now and make this a memorable trip.

My hometown of Columbia's slogan is Famously Hot. Yesterday it was 105 degrees with a heat index of 121. Stay cool, my friends!

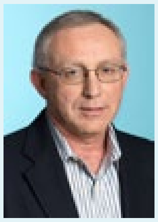
2018 Fall Conference

Denver, CO
Magnolia Hotel

Welcome Reception | Evening of September 11th
Conference Sessions | September 12-14th

Registration opening soon!

by Charles A. Samuels, Mintz Levin
General Counsel, NAHEFFA



Chuck Samuels

You enjoyed the carnage, intensity and adrenaline rush of the incredibly fast and intense 6 week fight over Tax "Reform" 1.0, which resulted in preserving private activity bonds but the elimination of advance refundings? If yes, then you can look forward with anticipation to the developing Tax Reform 2.0.

I wouldn't make this up. Republicans, particularly in the House where their majority is threatened, need to show new achievement. The tax cuts last year are perhaps the singular House achievement since, unlike the Senate, they have no role to play in judicial nominations. It appears that the Ways and Means Committee is developing a bill that might be unveiled around September with the idea of it passing in the House by the election. We have seen that the House is capable of quick action.

Two questions:

1. Will this bill be serious legislation that is developed with the idea of Senate adoption of a similar bill which can become law or will it be a "show bill," not designed for passage but to make a point, deliver a message ?
2. Will such a piece of legislation contain "pay fors," such as restrictions on private activity bonds, or will it simply be tax cuts and other nice goodies, maybe some technical corrections, without inflaming various constituencies with negative provisions? We'll see, but I think it will be a show bill and be limited on pay fors albeit it may have bond provisions banning stadia bonds or even some liberalization of private use rules under the infrastructure rubric.

Having said that, we need to be wary and watchful And we are. Along with our hospital and education allies and the governmental issuer Public Finance Network, we are talking to lots of folks on the Hill. So far they are reassuring, and many of them now claim to have been the ones that saved us last year! Victory has so many fathers and mothers. But nonetheless vigilance is required. We are in much better shape than last year. We won a bruising battle, many politicians will not want to go through that again, and we educated people about what private activity bonds really are – – nonprofits, housing, transportation, etc. But, Ways and Means Chairman Brady has threatened action on PAB's so we take it very seriously.

There is legislation to reverse the repeal of advance refundings. It would take a miracle for it to be enacted into law this year. Nonetheless, we are supportive of that legislation just as we are for the permanent liberalization of bank qualified which might have some chance in the infrastructure context. Meanwhile, borrowers are working around the advance refunding elimination in a variety of ways, including some current refundings, taxable refundings and other more exotic mechanisms.

There has been discussion about developing through existing law and with regulation refundings that are somewhat equivalent to advance refundings. One idea was for people to pay a penalty and be allowed to advance refund; that is a nonstarter. A second idea is a "toll" in which issuers/borrowers would pay some or all of the federal revenue loss while two sets of bonds are outstanding but still obtain an economic advantage. But will state and local governments write checks to Treasury? Another idea is "crippled slgs" in which there would be forced negative arbitrage to make up in whole or part the so-called revenue loss. There is not a huge outcry on the loss of advanced refundings at this point since so many were done late last year and interest rates have risen. But the calls for action will increase.

On other fronts, we supported just- enacted legislation that will put at least highly rated munis back into the category of "high-quality liquid assets" eligible for favorable treatment by bank regulators in big bank purchases. There is a split in the mutual fund community so attempts to reform the restrictive rules applying to mutual fund purchases of munis are somewhat problematic.

We are briefing up MSRB in order that they better understand conduit financings, and they have committed to revisit their guidance on municipal financial advisors and conduit financings which so far has proven to be unhelpful.

We'll stay in touch as developments occur and I look forward to seeing many of you in Denver.

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burden, high cost of social security promises, etc.) any time soon. That said we suspect the markets will eventually get around to believing they exist and start discounting the impact. Until that happens the more prudent approach is maintaining a more conservative, capital preservation approach.

CONCLUSION:
With market participants starting to head out of town to their favorite vacation spots market reactions to both good and bad news are likely to be accentuated. This helps make the seasonal summer period more volatile than normal. As a result don't be surprised to see wider swings in market averages over the next few months. Our investment strategy remains that of capital preservation - rather than stretching, taking on additional risk, in the hope of earning higher returns we are keeping client portfolios close to their neutral risk level as a hedge against rising downside volatility. This is an investment theme that we suspect will be with us for the rest of 2018. As always, thank you for your continued confidence and please contact us if you have questions, comments, or concerns.

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