Forbes

Small Muni Issuers See a Potential 620% Windfall for Their Taxpayers

Barnet Sherman

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Currently pending before the Senate, the Financial Data Transparency Act (S. 4295 – "FDTA") is legislation taking financial reporting by companies and municipalities to the next level. It ushers in the implementation of machine-readable, digitized financial reporting, wholly based on existing information that is already collected and required, and making it available to anyone for free.

For the municipal bond market, where disclosure has always been and remains a struggle, this legislation is potentially transformative. It creates access to and transparency in government financial reporting that, while the standard for public companies, is unprecedented in the public sector.

A Boon for Small Municipalities

It is also potentially a boon for small municipal bond issuers. The Financial Data Transparency Act has the potential to generate a 620% return on investment for small municipal bond issuers. Hard to believe? Read on.

The municipal bond market, with over 50,000 municipal entities, is the capital source for municipalities, nonprofits, and public authorities. Year to date, over 7,600 issuers have sold nearly $323 billion in bonds to borrow funds for projects such as hospitals, schools, town halls, and other public purposes.

Year in and year out, the largest number of borrowers are smaller or infrequent debt issuers. So far in 2022, half the market was in issuers with bond financings under $10 million. Bring that issuer number up to bond issues under $50 million, and 83% of the market issuance was from those smaller or infrequent borrowers.

Translating that into dollars from issuers, there were $76.6 billion of bonds sold by these issuers this year so far.

Getting it Right the First Time

If you're the finance head of a small city, town, or local authority, you likely just need to borrow once or twice a decade to fund, say, a water treatment plant or public safety building. You have only one chance to get it right—to issue bonds at the best interest rate. If you're off, even by just a few 1/100ths of 1% (known as a 'basis point' in bond-speak), that additional cost is coming out of your budget and your taxpayers' dollars and into the pockets of bondholders for as long as the next 30 years.

Moreover, investors know that once they buy a bond of a small issuer or small issue, they generally can't readily trade out of those bonds without taking a substantial discount on the value. Moreover, follow-up disclosure from the issuer may not even be required. That means the market will not have critical financial information, making it difficult to get an accurate or even fair value on their bonds.

Correspondingly, investors charge what is known as a 'liquidity premium'—a higher rate of interest that charges for the lack of the ability to sell, track, or get an accurate valuation on the bonds. As you will see, that means millions of dollars that could be otherwise used for public purposes go to bondholders, not back into the community.

Turning the Tables

The Financial Data Transparency Act could flip that around. The FDTA brings disclosure into the digital age by defining data tags based on the existing financial information collected by a municipality or public authority.

Having structured data, categorized by established accounting rules (i.e., GAAP or GASB), and reported in a digital format, makes it simpler for a small borrower to collect, prepare and, with a click, send out. It is the trifecta of speed, efficiency, and transparency.

Do the Math: 2/100th of 1% = $716,500

What does this translate into putting taxpayer dollars back into the budget? In a rising interest rate environment, where every basis point matters, let's say this better information shaves down the liquidity premium by just a modest two basis points—2/100th of 1%—on a 30-year bond.

That's a windfall averaging $716,500 per small issuer. It's like a winning lottery ticket paying about $24,000 a year for 30 years back into the community. That doesn't even count the savings from simplifying existing cumbersome and time-consuming processes requiring filing by paper or PDF.

Looking a Gift Horse in the Mouth

Of course, there are always those that will look a gift horse in the mouth. One government financial professional association claimed that upgrading existing outmoded legacy technology to generate machine-readable reporting will mean some municipalities may have to invest between $50,000 to $100,000 at a minimum to upgrade those systems.

These numbers are either anecdotal at best or misleading at worst. Either way, unfortunately, they reflect a woeful lack of understanding of data, tagging, and technology. As the Cato Institute correctly notes, data languages are just tagging systems applied to finalized financial statements. The tags applied to the reports are defined by the existing information collection standards by the government entity, which means, in nearly all cases, they are framed by GAAP standards.

Additionally, not only do the reporting requirements remain the same, but they are given greater significance because machine-readable tags are defined for them. Accounting systems in place stay as they are. No accounting systems need to be rewritten or replaced.

Moreover, there are disclosure exemptions for some small bond issuers. Those issuers may not even be touched by the legislation.

Finally, a survey by the American Institute of Certified Public Accountants (AICPA) reports that most small public companies spend less than $5,500 to comply with the existing SEC digital filing mandate. It is hard to imagine a small municipality needs over ten times the amount a small public company does to file digitally, even with the initial upgrade investment!

620% Return on Investment

But let's play along anyway. Even at the top end of those numbers, with a $24,000 annual recoupment, that initial $100,000 investment gets paid back in a little over 4 years. After that, on a 30-year bond, next 26 years are free and clear savings that stay in the municipal coffers. Taxpayers get a potential net 620% return on investment.

Now, if the FDTA can bring about that kind of return for taxpayers through better data and technology, I hope another law gets passed that helps stock market returns the same way. After this year, my portfolio sure could use a boost.