

Tender Option Bonds

2023 Ratings Recap

S&P Global
Ratings

Mindy Xu

James Ho

Feb. 14, 2024

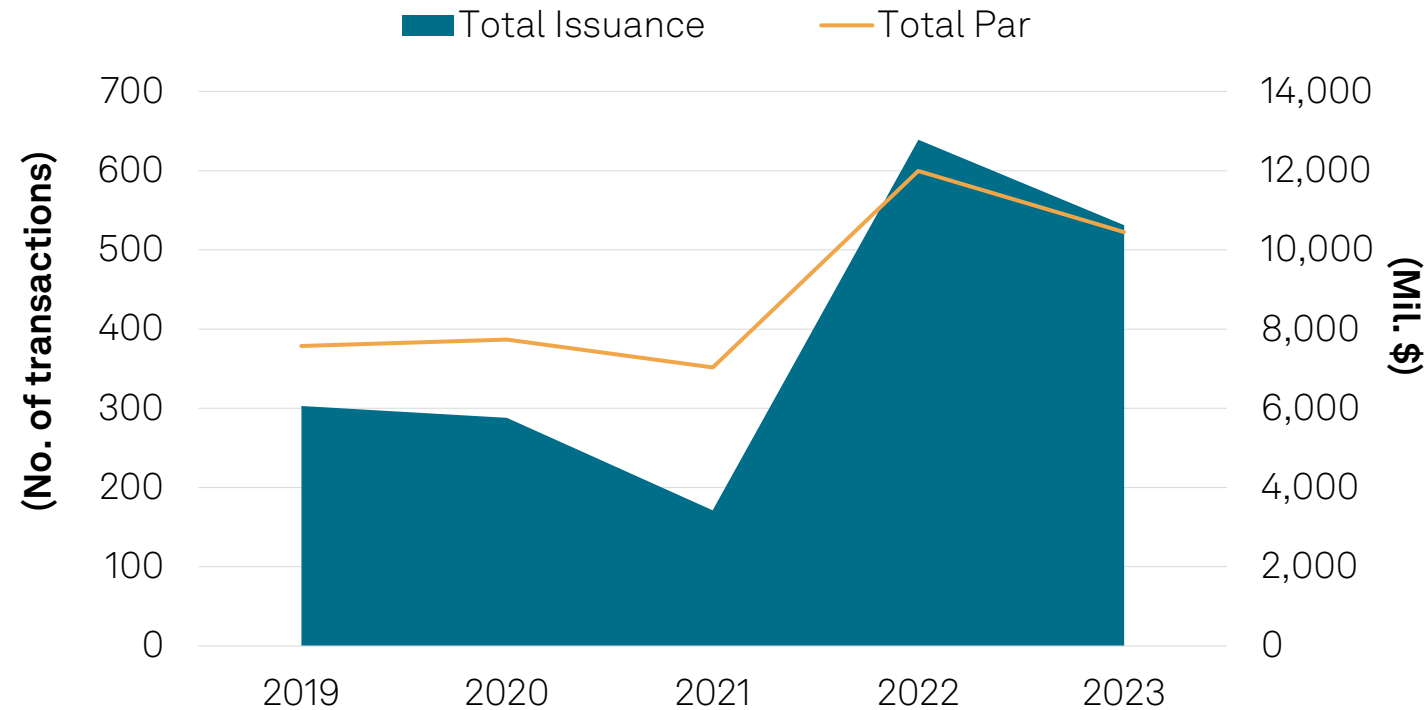
This report does not constitute a rating action

Tender Option Bond (TOB) Highlights

- We expect **relatively stable 2024** TOB ratings performance for the near term given the credit stability across most of public finance sectors and the liquidity banks. However, high interest rates and inflation, coupled with expected slower economic growth this year, may apply additional credit pressure and challenges to some public finance sectors.
- We anticipate 2024 new issuance volume to be **similar to what we saw in 2023**.
- **Strong issuance in 2023** was largely due to refinancing of existing low-yield trusts.
- Citibank will **exit the TOB market** in 2024. Existing Citibank-supported transactions will be substituted to other liquidity providers or unwound.

2023 New Issuance Volume And Par | Refinancings Drive New Issuance

Total issuance and par

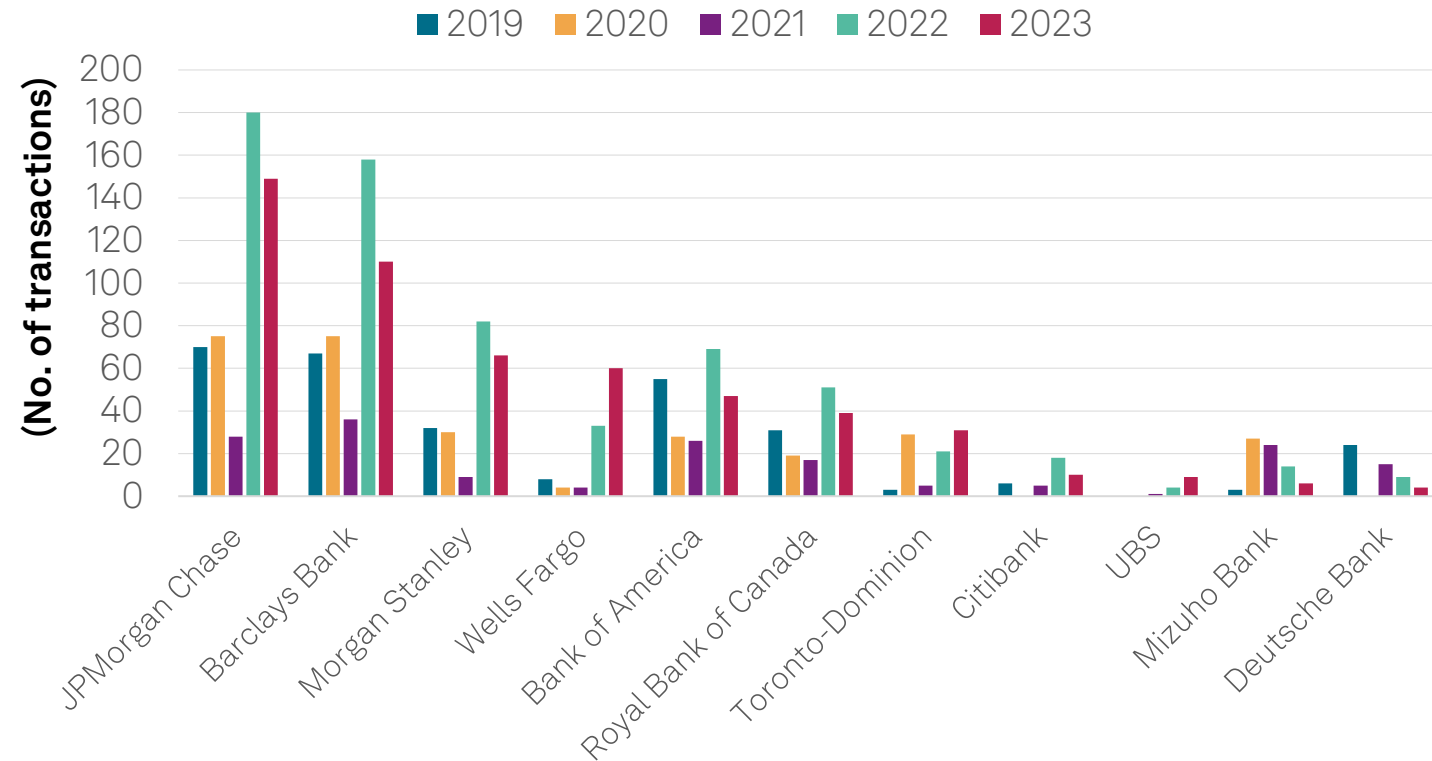


- The strong issuance over 2022 and 2023 is largely due to the refinancing of existing low-yielding trusts. The restructuring continued in 2023.
- As interest rates has risen over the year, TOB sponsors have been terminating low-yield trusts and creating new ones to maintain levered positions.

Source: S&P Global Ratings.

TOB New Issuance Liquidity Banks

Transactions per year by liquidity bank

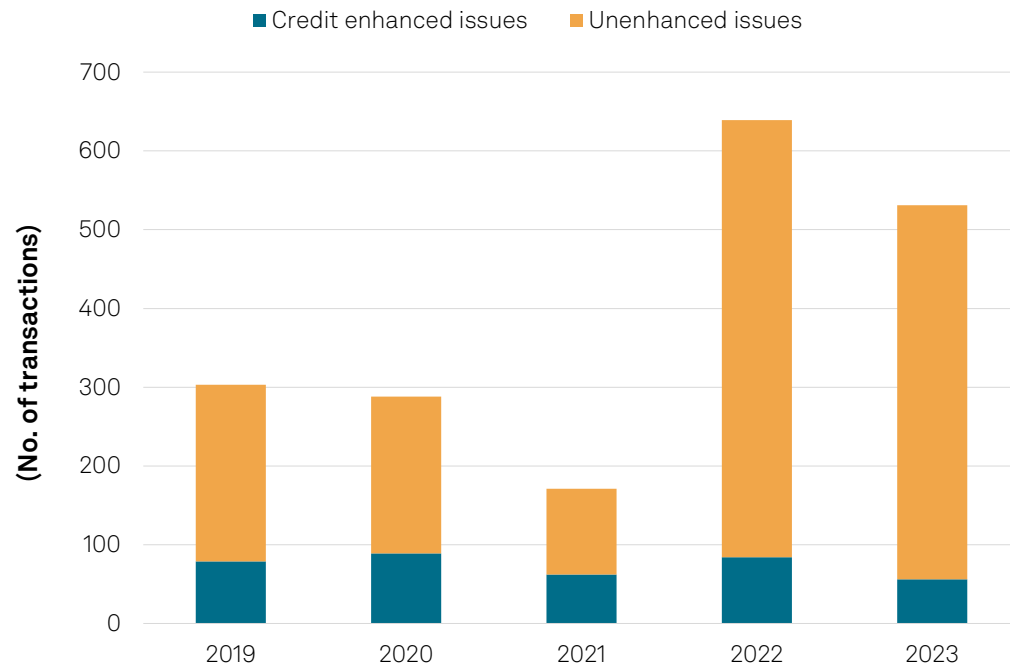


Source: S&P Global Ratings.

- JPMorgan Chase, Barclays Bank PLC, and Morgan Stanley Bank remain the top three banks providing liquidity to TOB transactions.
- Wells Fargo Bank has also substantially increased its liquidity support of TOBs as compared to previous years.
- UBS also added a new S&P Global Ratings-rated TOB program.
- Although Citibank issued new TOBs in 2023, it will exit the TOB market in 2024 as Citigroup has shut down its municipal business. Existing Citibank-supported transactions will be substituted to other liquidity providers or unwound.

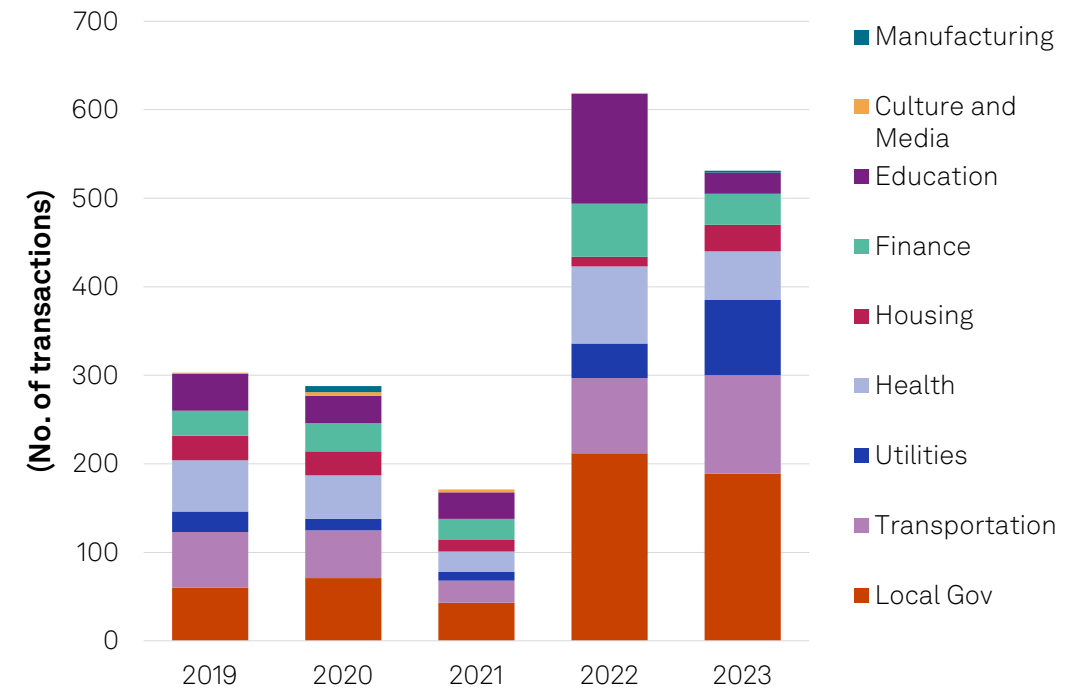
TOB New Issuance Credit Enhanced Vs. Unenhanced Transactions And Underlying Sectors

Credit enhanced vs. unenhanced issues by year



Source: S&P Global Ratings.

New transactions per underlying security sector



Source: S&P Global Ratings.

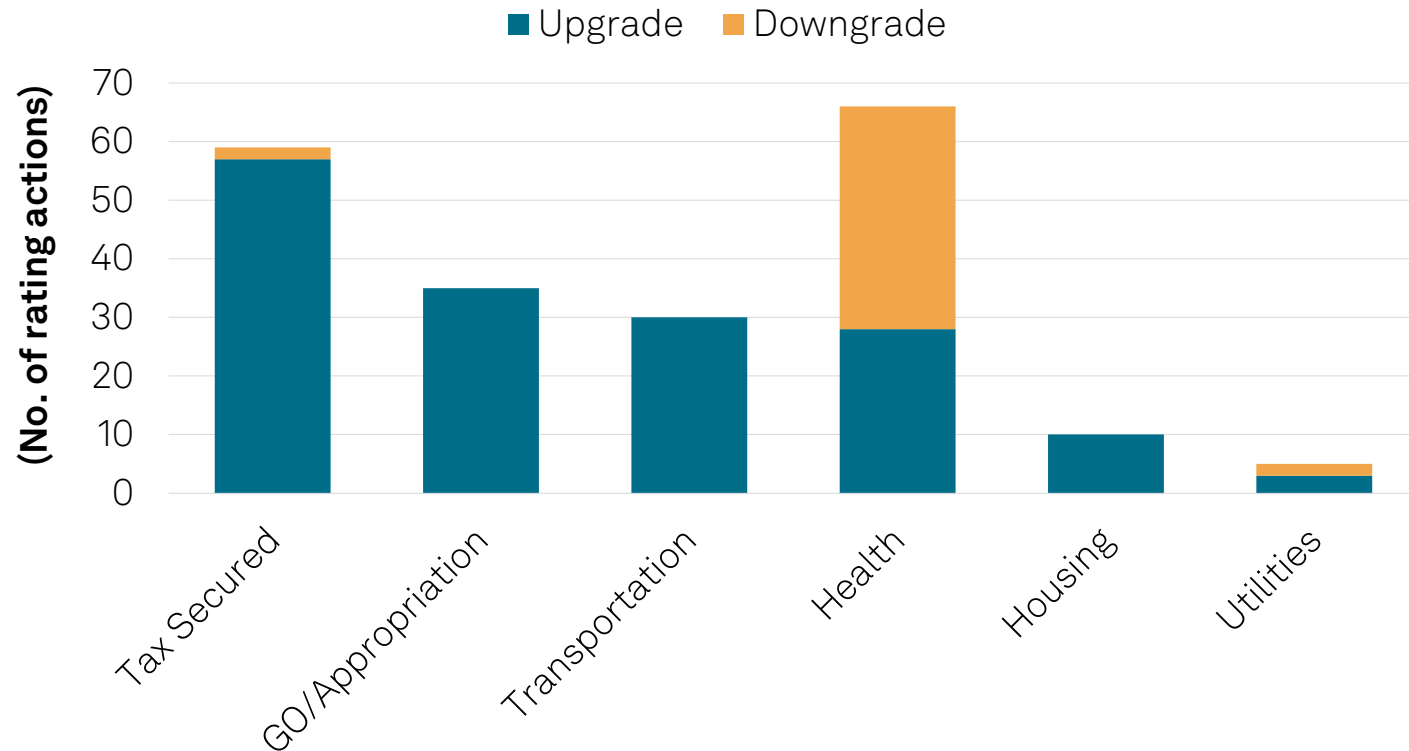
TOB Rating Actions In 2023

- Out of the 281 total ratings upgrades in 2023, 42.7% of the total upgrades were related to two bank rating actions: the upgrade of Barclays Bank PLC and the upgrade of Deutsche Bank.
- The other 57.3% of rating upgrades were related to upgrades in the underlying municipal bonds.



TOB Rating Actions By Underlying Security Sector

Rating actions in 2023 by sector and type



Source: S&P Global Ratings.

- Out of the total 329 rating actions that took place in 2023, upgrades accounted for 85.4% of rating actions, up from 68.8% in 2022, primarily due to improved credit conditions of the underlying securities and the related public finance sectors (i.e., tax secured, general obligation (GO)/appropriation, etc.) and liquidity banks.
- Meanwhile, downgrades accounted for 14.9% of rating actions, primarily due to downgrades in the health care sector.
- We expect relatively stable 2024 TOB ratings performance for the near term given the credit stability across most of public finance sectors and the liquidity banks.

Outstanding TOB Portfolio

The trend of TOB trust unwinds continued in 2023. Although we rated over 500 new sale trusts, the total outstanding rated portfolio shrunk by over 300 TOB trusts.

Outstanding TOB portfolio

	2021	2022	2023
Total TOB trusts	1,568	1,619	1,305
Total TOB ratings	3,389	3,166	2,500
Total par (bil. \$)*	42.59	36.17	31.54

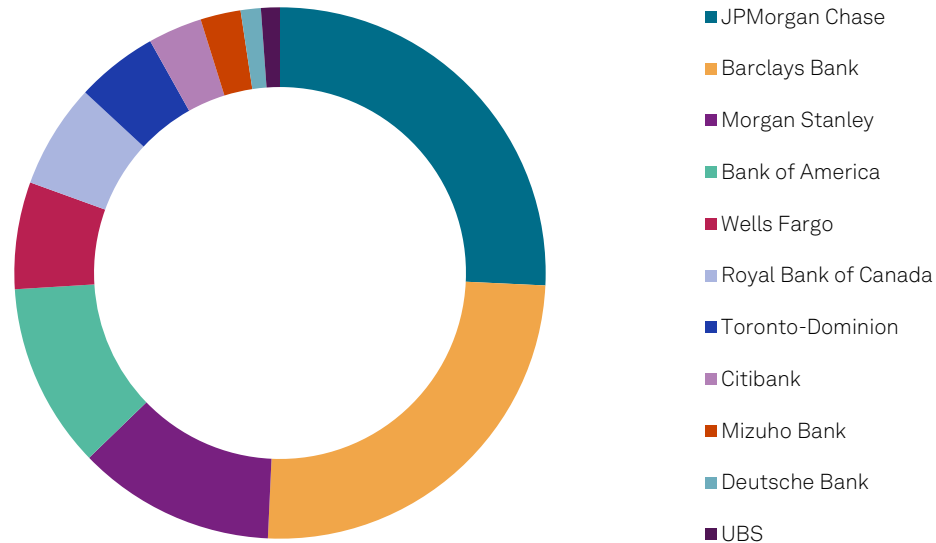
*Not including custodial receipts. TOB--Tender option bond.

TOB Total Portfolio Breakdown

- JPMorgan Chase Bank supports the most transactions at 26%, followed by Barclays Bank PLC and Morgan Stanley Bank at 25% and 12%, respectively.
- Within the credit enhancement space (currently 18% of the total portfolio), Barclays Bank PLC supports 57%, followed by Mizuho Bank and RBC each at about 13% of the credit-enhanced TOB portfolio.

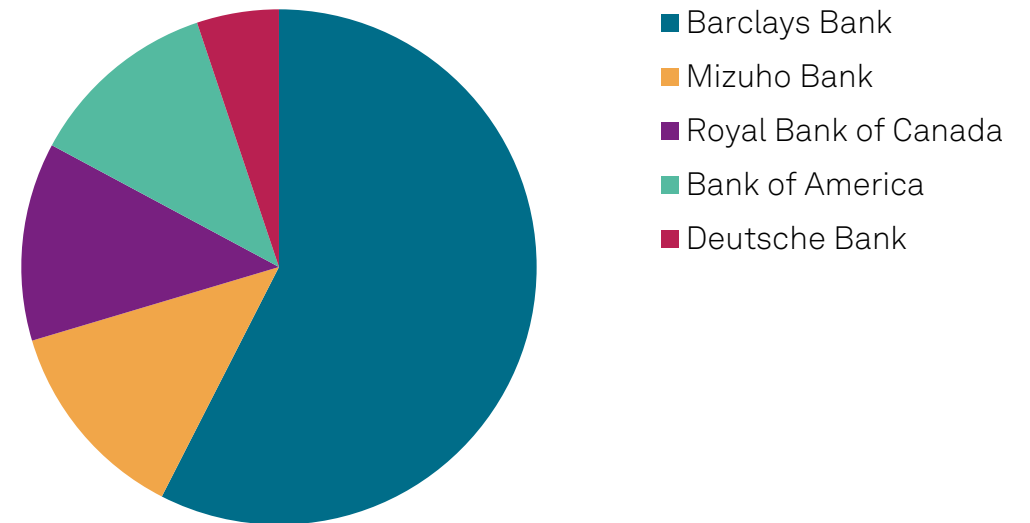
By liquidity bank

Total transactions by liquidity bank



By credit enhancer

Total transactions by LOC bank



LOC--Letter of credit. Source: S&P Global Ratings.

Recent TOB Publications

On Jan. 26, 2024, S&P Global Ratings reported that the average leverage ratios for U.S. fund-sponsored TOB trusts remain elevated as short-term total returns for U.S. municipal bond closed-end funds (CEFs) continue to decline (see “U.S. Fund-Sponsored Tender Option Bond Leverage Remains Elevated As Short-Term Losses Rise,” published Jan. 26, 2024).

Although the cost of financing has increased along with interest rates, tax-exempt financing (reflected by the Securities Industry and Financial Markets Assn. [SIFMA] Municipal Swap Index) has remained attractive relative to taxable financing (reflected by SOFR). This has led to an increase in tax-exempt, bank-sponsored, TOB trusts. Bank-sponsored, tax-exempt TOB trusts surged in 2023 as the SIFMA Municipal Swap Index remained roughly 35% lower than SOFR, on average. We believe banks will continue to seek tax-exempt TOB financing because this approach fits into their overall balance sheet strategies. (see “Banks Switch Gears To Tax-Exempt TOBs As Taxable Rates Hit New Highs,” published Sept. 9, 2023).

This mid-year review provides a high-level overview of activity in the U.S. TOB market. In addition to a review of recent rating actions, this report discusses TOB issuance trends, municipal bond issuance activity, the rising costs of portfolio leverage, and our expectations of TOB issuance and credit performance in the second half of 2023 (see “2023 Mid-Year Review: Tender Option Bond Issuance Continued Despite Headwinds,” published Aug. 3, 2023).

Other reference articles:

- 2024 Outlook For U.S. Public Finance: A Mixed Credit Picture, Feb. 2, 2024
- U.S. Public Power And Electric Cooperative Utilities 2024 Outlook: Mandates, Rising Costs, And Diminishing Affordability, Jan. 23, 2024
- US Public Finance 2023 Year in Review, Better Than Expected, Dec. 12, 2023
- Global Banks Outlook 2024, Nov. 16, 2023
- Deutsche Bank Issuer Credit Ratings Raised To 'A/A-1' On Strengthening Performance And Resilience; Outlook Stable, Dec. 8, 2023
- Barclays PLC Upgraded To 'BBB+' On Business Diversification And Resilient Performance; Outlook Stable, May 19, 2023

Primary credit analysts

Mindy Xu

Director

212-438-2879

Mindy.xu@spglobal.com

James Ho

Senior Analyst

212-438-1306

James.ho@spglobal.com

Research assistants

Sophia Frohna

Research Assistant

773-441-3385

Sophia.frohna@spglobal.com

Liam Felter

Research Assistant

303-229-2273

liam.felter@spglobal.com

Kyle Lutz

Research Assistant

720-468-6548

Kyle.lutz@spglobal.com

Research contributors

Pooja Vador

Pankaj Tari

Nalini Singh

Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge) and www.ratingsdirect.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/ratings/usratingsfees.

Australia: S&P Global Ratings Australia Pty Ltd holds Australian financial services license number 337565 under the Corporations Act 2001. S&P Global Ratings' credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.

spglobal.com/ratings

S&P Global
Ratings