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Premium vs. Par Refunding, Reporting, Tax Management



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Advance Refunding of Premium Bonds

Intended purpose of refunding provision: enable borrower to benefit from declining rates

Premium bonds likely to be refunded even if rates rise

Intermediaries live and die on transactions

Savings make municipal issuer look like a hero

But at a significant transaction cost

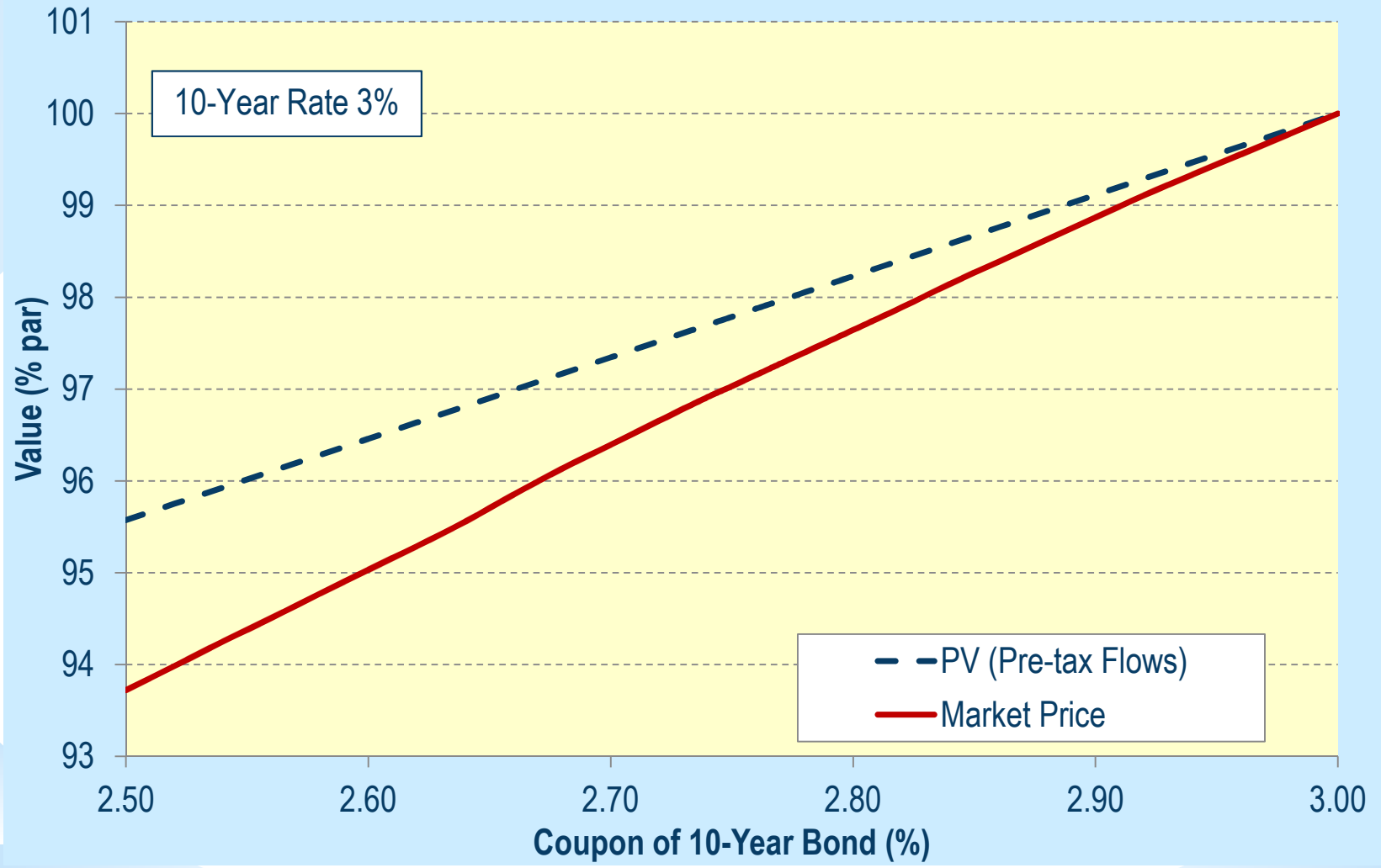
Institutional investor benefits in several ways

Pre-refunded bond is AAA-rated

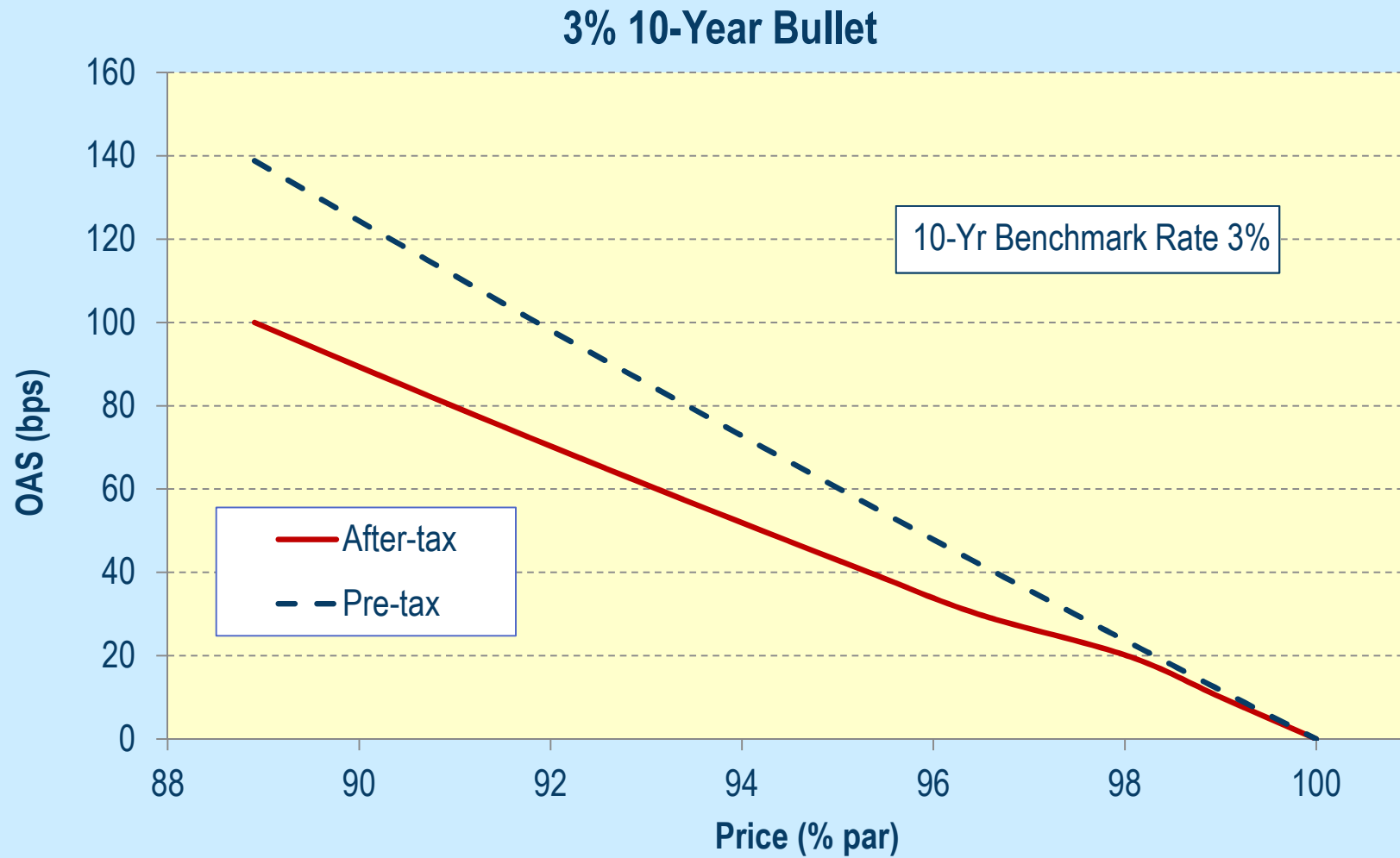
Issuers tend to refund prematurely (threshold too low)

Pre-refunding guarantees bond will be called

Reporting: Taxes Depress Prices of Discount Munis



Ignoring Taxes → Credit Spread Overestimated



Tax-Beneficial Sales Can Enhance Performance

Tax treatment depends on investor's basis

Purchase price/date determines basis over holding period

Gain/loss short-term or long-term

Right to execute tax-beneficial trades is an option

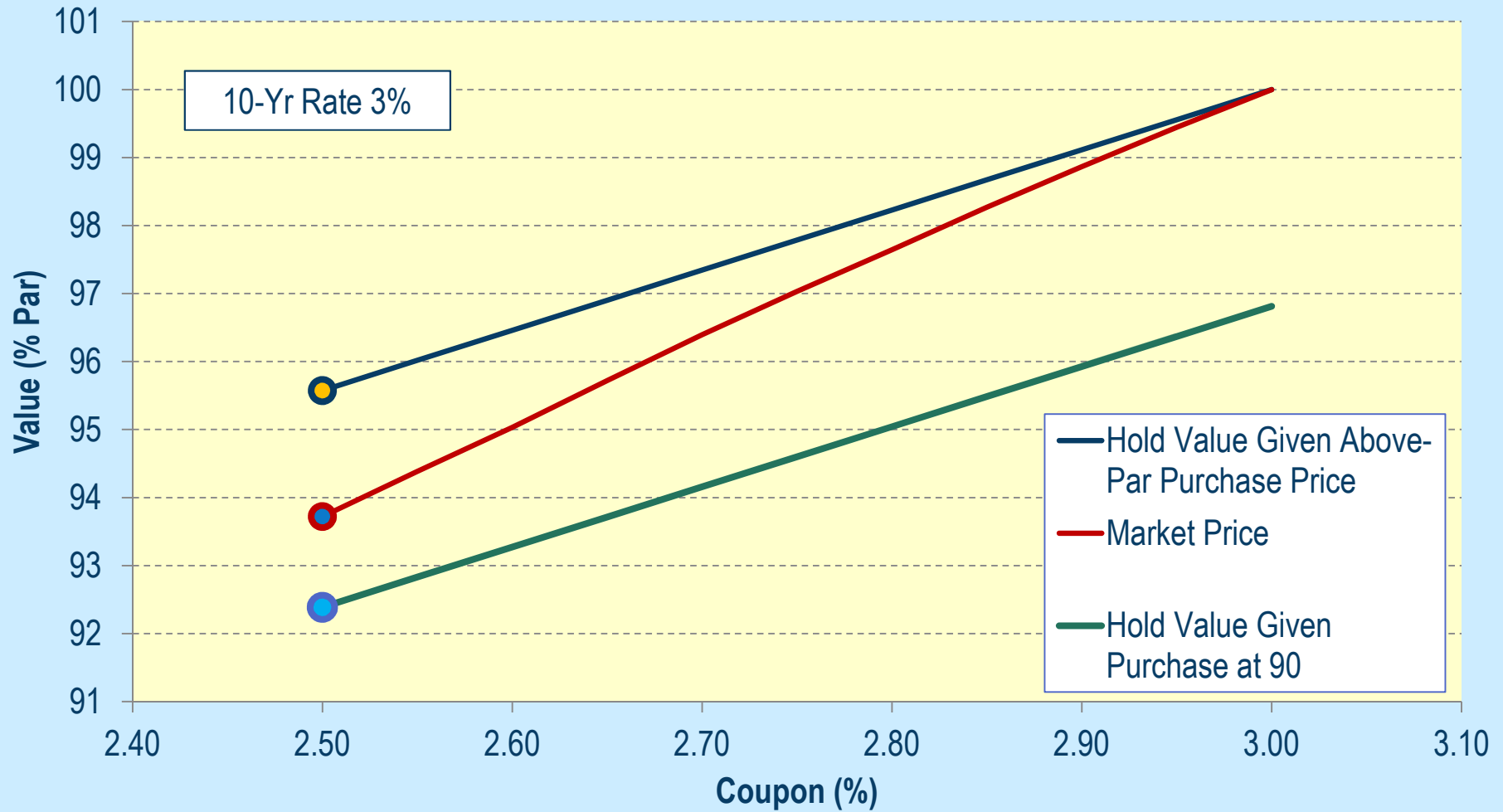
Acquired automatically, at no cost, upon purchase

Under dynamic management a sequence of 'tax' options come into play

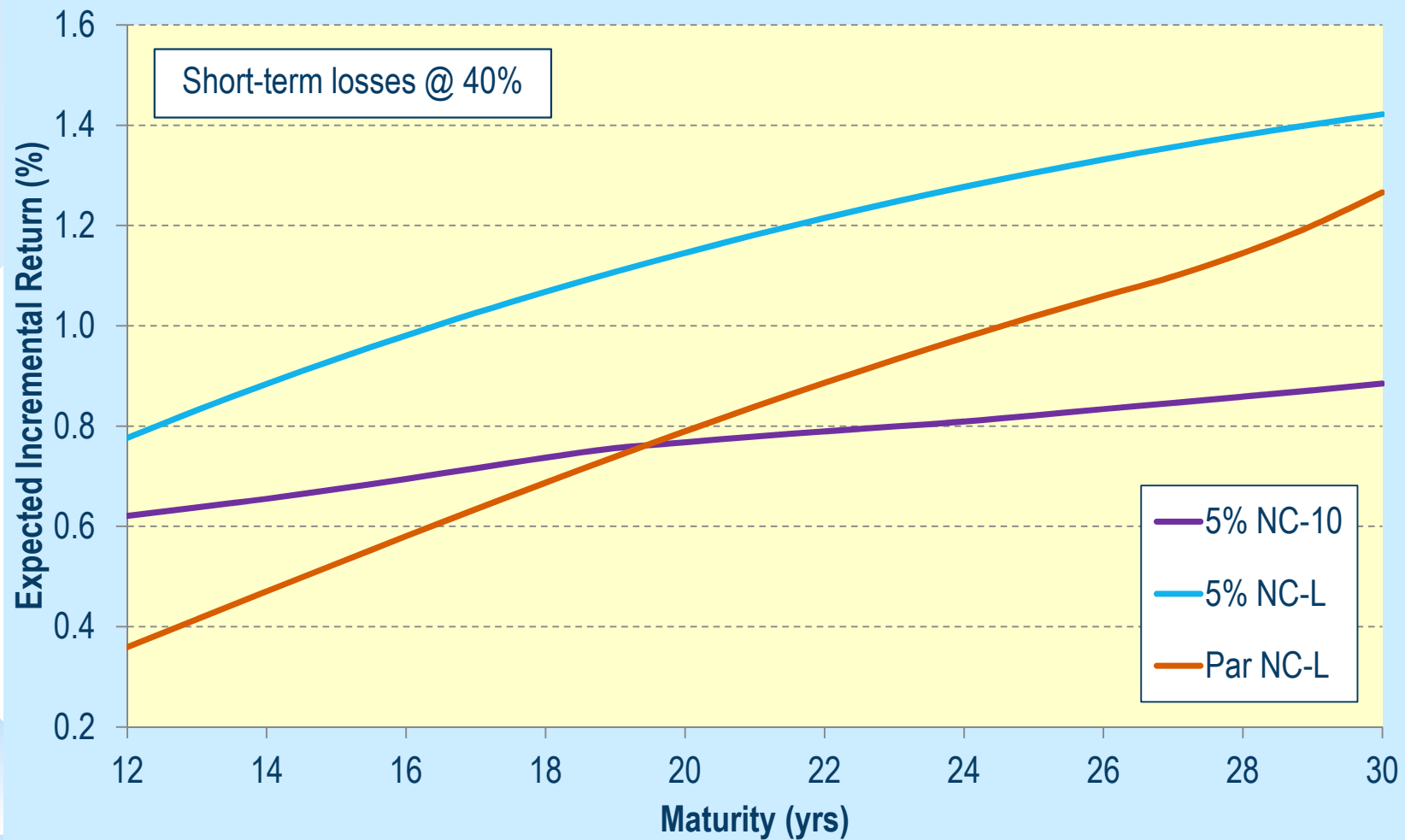
Can be valued using OAS analytics

Hold Value Is Critical Input to Sale Decision

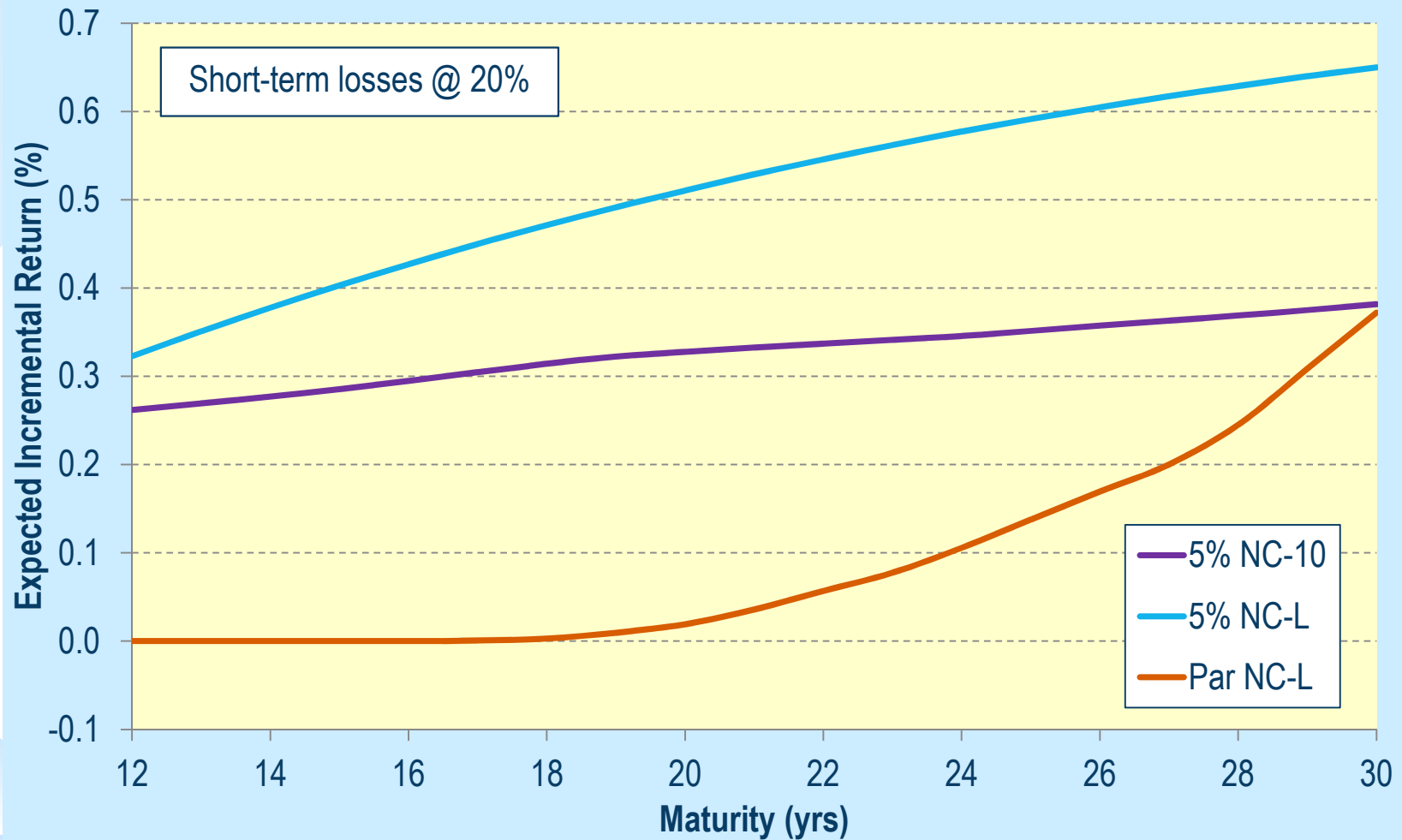
10-Year Bullets



Performance* Boost From Tax Management Various Maturities – One Year Horizon



Performance* Boost Reduced If Short-Term Losses Are Offset Against Long-Term Gains



What's Right with Par Bonds?

Suitable for buy-and-hold investors not concerned with mark-to-market

Individuals

Institutions using 'hold-to-maturity' accounting

Greater upside than premiums when rates decline