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Municipal Debt Issues in Foreign Markets: Managing Currency and Interest Rate Risk

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Abstract

Since the mid-1980s, there has been an acceleration of state and local government interest in the taxable bond market as a source of capital. This has resulted from, among other factors, restrictions imposed on economic and industrial development loan programs resulting from the passage of the Tax Reform Act of 1986. Increased state and local government involvement in the taxable bond markets has increased competition for such capital between the public and the private sectors. In turn, the developing capital competition has expanded into overseas securities markets. Private sector corporations have frequently accessed foreign capital markets to take advantage of lower interest rates and reduced financing costs. By contrast, state and local governments have accessed such markets only recently. This article discusses the policy issues considered by a state or local government entity when it decides to borrow funds in foreign markets and discusses the issues involved in managing currency and interest rate risk when issuing municipal bonds in foreign markets. It includes a review of the hedging techniques used by the Kentucky Development Finance Authority (KDFA) to protect against changes in the Yen/Dollar exchange relationship on a recent Samurai bond issue sold by KDFA as an example of such a transaction.