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Patent Sought for Tax Credit Bond Idea

by: [Christine Albano](#)

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An independent consultant and former Wall Street investment banker is spearheading an effort to introduce a new tax credit structure to the municipal market modeled as an alternative to traditional bond insurance - but without the third party risk.

Paul Fennell, owner of Fennell Advisory LLC in Scottsdale, Ariz., is in the publishing stage of the patent process with the United States Patent and Trademark Office to establish the new product, called Tax Offset Municipal Securities, or TOMS.

The patent-pending concept would essentially act as a safety net for bondholders in the event that a municipality defaults on an interest payment, Fennell told The Bond Buyer. Bondholders with matching tax liabilities would be granted an equivalent tax credit as an offset - all without relying on the ability or discretion of a third party to make payment, he explained.

For issuers it's a win-win situation - they only forfeit discretion over a portion of the bondholder's taxes - and then only when in default, Fennell noted. "What bond holders get in return is the certainty of knowing they will receive value one way or another," he said.

While all the details are still being fined-tuned, one of the stipulations allows bondholders the option of exchanging their bonds for tax credits at any given time throughout the life of a bond. The issuer would have to be an entity that collects taxes and the investor would have to be a taxpayer in that jurisdiction in order to benefit from the tax credit. A non-taxable bondholder, like a mutual fund, on the other hand, would receive a tradable tax credit, he added.

The structure can be used as a financing tool by any tax-imposing issuer - provided cities and states gain legislative approval first, just as they would any other standard tax item, he explained. "While there are lots of innovations out there, they are mostly tax incentives," not pure tax credits, Fennell said.

TOMS seek to curtail some of the skepticism still felt by investors as a result of the "hangover of 2008" by providing high-quality credit enhancement that insulates holders from credit exposure and "retains full value in almost any scenario," according to Fennell.

He views the concept as "rock solid" as it is a timely financing option that is unique and different -especially given the implosion of the bond insurance industry and as municipalities are struggling to cut costs and improve their credit quality.

"Muni bond insurance is dead, particularly at the state level - it really doesn't exist in the form of a triple-A insurer," Fennell explained. "I have heard other people getting insurance models together - but the well-known insurance models are subject to the problems people are familiar with," he continued.

Fennell believes TOMs will be successful because they are created with "an economic concept that is secure and that people can understand."

He views the concept as advantageous and "very compelling" for issuers, who could achieve upwards of five basis points in cost savings - especially if they are highly regarded by the market.

If his patent is granted, he said he will seek support for TOMS from the rating agencies. "The real test will be where the market prices them, and what the rating agencies have to say about it," he said, adding that preliminary discussions with seasoned rating agency experts indicate they are interested in the innovation.

"If this was seen by the market as a triple-A credit, I couldn't think of a more secure explanation than knowing [an investor] can get a credit against his taxes," Fennell said. "You are covered in a way that beats any other triple-A insurance model that I can think of."

He first filed for the patent in April 2011 after discussing his idea with former Salomon Brothers colleague Andrew Kalotay, who is partnering with Fennell to market the product. Kalotay owns New York-based debt management advisory firm Andrew Kalotay Associates.

While it could take another year or so before the would-be product eventually makes it to market, Fennell believes his idea is an evergreen concept that will have longevity as long as taxes exist.

A graduate of Amherst College and Dartmouth College - The Tuck School of Business, Fennell was a vice president from 1982 to 1987 at the former Salomon Brothers in New York City where he focused on corporate and high-yield finance. Most of his career, however, has centered on private consulting and real estate finance from his Arizona headquarters. He started his own company in 2008, and currently has a clientele that includes small businesses and corporations.



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