

The Gradual Then Sudden Rise of Municipal Gas & Electric Prepay Bonds

AMPWP Fixed Income Sector Brief



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A Market Hiding in Plain Sight

The modern municipal prepay bond originated from laws passed in Louisiana during the 1980s.ⁱ What began as a specialized financing method for public utilities has evolved into a substantial component of the tax-exempt market. 1994 was a key turning point. In December, the City of Clarksville's Natural Gas Acquisition Corporation closed the first municipal natural gas prepayment, issuing \$26.3 million of gas revenue bonds to prepay 10 years of supply from Louis Dreyfus.ⁱⁱ At the end of 2025, prepay structures ranked among the top ten in the Bloomberg Municipal Bond Index by market value (ranked ninth).ⁱⁱⁱ The scale is no longer speculative; it is well established.

Prepay bonds sit at the crossroads of satisfying a public purpose, long-term power supply agreements, and structured finance. A conduit or issuing authority typically issues bonds and uses the proceeds to secure a multi-decade supply of commodities at a discount that a municipal gas or electric utility purchases. The utility's retail customers benefit from a stable source of energy and or fuel supply. Investors receive tax-exempt income linked to a chain of contracts via the bond offering. The promise is orderly, but the reality requires judgment and a keen understanding of the structure.

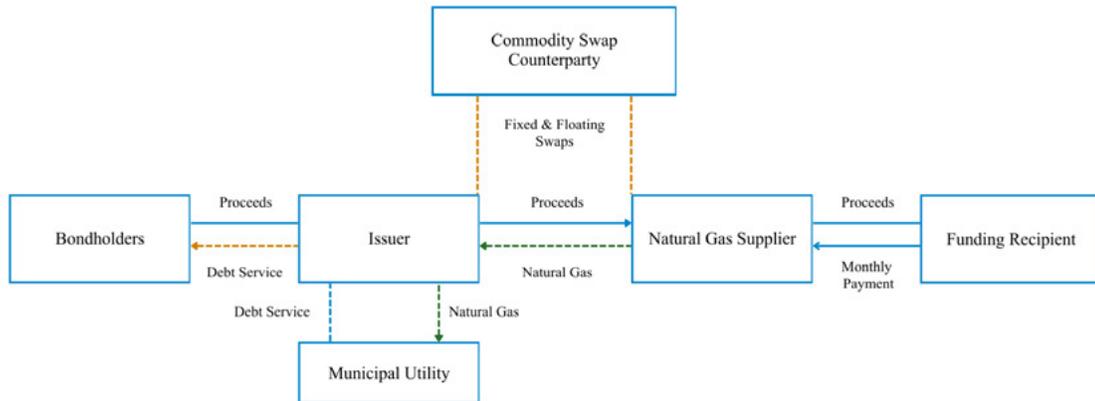
Bloomberg Municipal Bond Index

Sector	Par Val	Market Value	Weight
1 State (6180 members)	\$194,333,004	\$209,341,420	10.85
2 Hospitals (4880 members)	\$170,804,843	\$173,824,308	9.01
3 School District (8701 members)	\$164,666,623	\$166,893,344	8.65
4 Water and Sewer (6419 members)	\$152,031,182	\$160,410,792	8.31
5 Appropriation (4839 members)	\$131,756,950	\$134,026,843	6.95
6 Airports (3720 members)	\$122,882,720	\$128,800,014	6.68
7 Higher Education (3718 members)	\$104,376,605	\$112,102,987	5.81
8 Toll Roads, Bridges and Tunnels (2471 members)	\$99,829,333	\$100,823,311	5.23
9 Gas Forward (330 members)	\$92,052,120	\$99,311,720	5.15
10 Income Tax Financing (1577 members)	\$88,506,325	\$93,731,365	4.86
11 City (2764 members)	\$62,952,605	\$66,919,534	3.47
12 Electricity and Public Power (1976 members)	\$60,613,637	\$64,160,183	3.33
13 Sales Tax (1645 members)	\$48,755,265	\$51,913,137	2.69
14 Single-Family Housing (2277 members)	\$51,068,284	\$51,301,524	2.66
15 County (2571 members)	\$34,554,345	\$36,623,325	1.90
16 Miscellaneous Tax (1043 members)	\$37,040,763	\$35,278,809	1.83
17 Tax Backed District (1630 members)	\$34,311,140	\$34,574,243	1.79
18 Combined Utilities (1442 members)	\$30,154,950	\$32,174,316	1.67
19 Multi-Family Housing (912 members)	\$30,315,748	\$29,112,575	1.51
20 Non-Toll (786 members)	\$24,817,360	\$26,895,160	1.39
21 Economic and Industrial Development (240 members)	\$20,347,130	\$20,833,865	1.08
22 Farebox (Mass and Rapid Transit) (323 members)	\$16,110,080	\$16,415,526	0.85
23 Primary and Secondary Education (453 members)	\$13,326,785	\$14,435,096	0.75
24 Other (359 members)	\$10,418,560	\$10,704,113	0.55
25 Bond Bank (587 members)	\$10,055,776	\$10,640,943	0.55
26 Ports and Marinas (330 members)	\$8,801,320	\$8,429,517	0.44
27 Tobacco (135 members)	\$6,995,910	\$7,009,072	0.36
28 Continuing Care Retirement Centers (299 members)	\$7,178,280	\$6,983,014	0.36
29 Student Housing (293 members)	\$6,316,501	\$6,427,974	0.33
30 Guaranteed (394 members)	\$6,283,965	\$6,136,904	0.32
31 Charter Schools (209 members)	\$4,901,268	\$4,796,703	0.25
32 Student Loans (154 members)	\$2,759,750	\$2,778,440	0.14
33 Tax Increment Financing (144 members)	\$2,087,320	\$2,206,328	0.11
34 Mello Roos (37 members)	\$961,280	\$996,034	0.05
35 Resource Recovery (44 members)	\$831,795	\$882,240	0.05
36 Special Assessment (27 members)	\$550,290	\$569,252	0.03
37 Private Schools (16 members)	\$450,025	\$484,687	0.03
38 Parking Facilities (18 members)	\$312,170	\$323,261	0.02
39 Nursing and Assisted Living (2 members)	\$70,055	\$64,101	0.00

How the Structure Works

The basic architecture is fairly straightforward to describe but complex to analyze. A public utility agrees to buy a specified amount of natural gas or electricity over a long-term period, usually 30 years (akin to buying in bulk at a discount). Bond proceeds provide the initial prepayment to an energy supplier, which commits to delivering a specified amount over a fixed timeframe. A network of swaps and delivery agreements align prices, volume, and certain risk transfers.

Basic Overview



Public ratings often refer to the credit quality of the funding recipient (typically a financial institution). While this can be useful for assessing risk at a surface level, it can also be misleading once you dig deeper into the related bond offering documentation. The funding recipient does not guarantee the repayment of principal or interest on the bonds. For instance, structural security depends on a series of factors such as the related contracts, take-or-pay provisions related to off-takers, delivery obligations, collateral arrangements, call features, and triggers that may define a ledger event. Investors who do not review these terms are effectively investing in a name rather than a structured security and are relying on public ratings.

Geography Tells a Story^{iv}

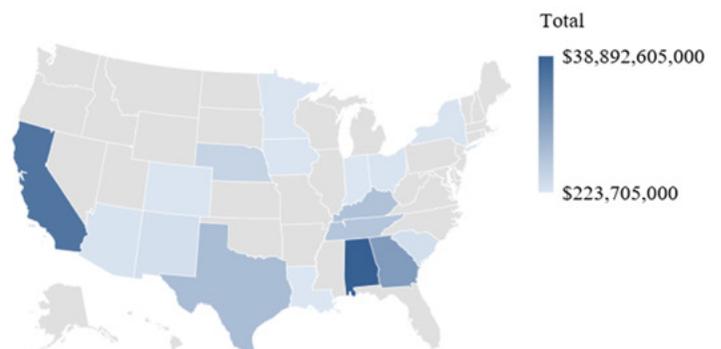
Prepay issuance is not random. It tends to cluster where physical networks and policy preferences meet. Gas pipeline maps help explain why certain regions sponsor multiple programs. For instance, Alabama's Black Belt Energy Gas District is one example on the natural gas side. California's market is a leading example on the electric side, thanks to Community Choice Aggregators that have sponsored large electricity prepay programs. Infrastructure drives feasibility, and local governance and laws drive scale.

Issuance by State (2002-2025)



Blue = Intrastate Gas Pipeline

Red = Interstate Gas Pipelines

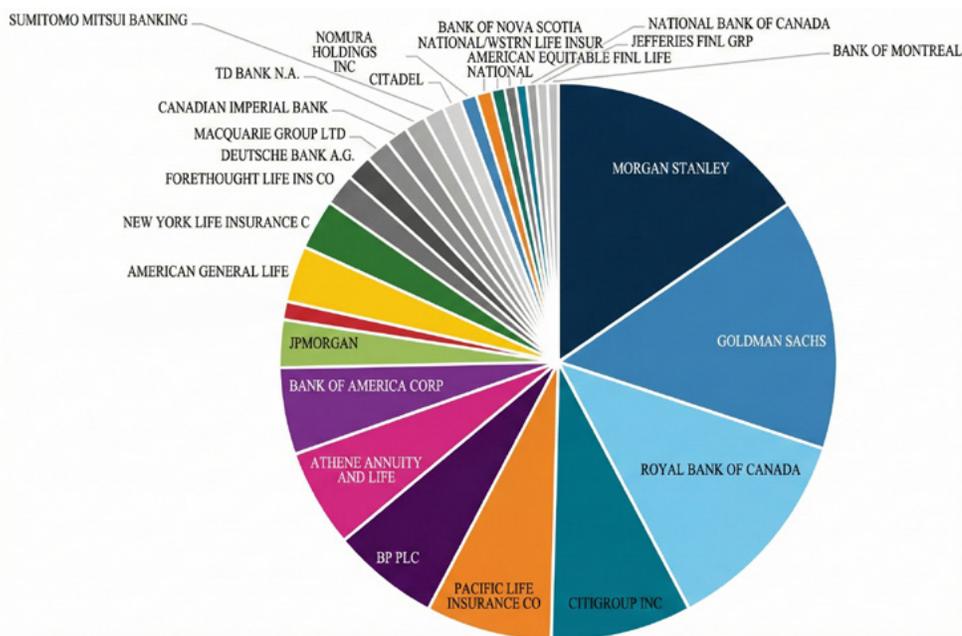


The Counterparty Shift

The history of funding recipients illustrates the evolution of the market. From around 2006 to 2018, major U.S. financial institutions held this role. Banks with trading and physical energy operations provided the balance sheets and execution platforms needed for prepayments. The landscape began to diversify in 2019, with Macquarie engaging in a Main Street Natural Gas transaction. BP later participated in a Kentucky Public Energy Authority deal. Royal Bank of Canada took part in a Black Belt Energy transaction in 2021. More entrants soon appeared, including Canadian Imperial Bank, Citadel, and Nomura.

The period from 2023 to 2025 marked a major turning point. Insurance companies became the largest recipients of funding. American General Life, New York Life, Athene, Pacific Life, and others participated in multiple California community choice deals and regional issuances. Banks outside the original group also entered, including National Bank of Canada, Deutsche Bank, and Bank of Montreal. The common theme was a search for long-term, well-structured cash flows that match institutional liabilities. The message for investors is clear: counterparty analysis can no longer rely on a single model.

Funding Recipient Market Composition

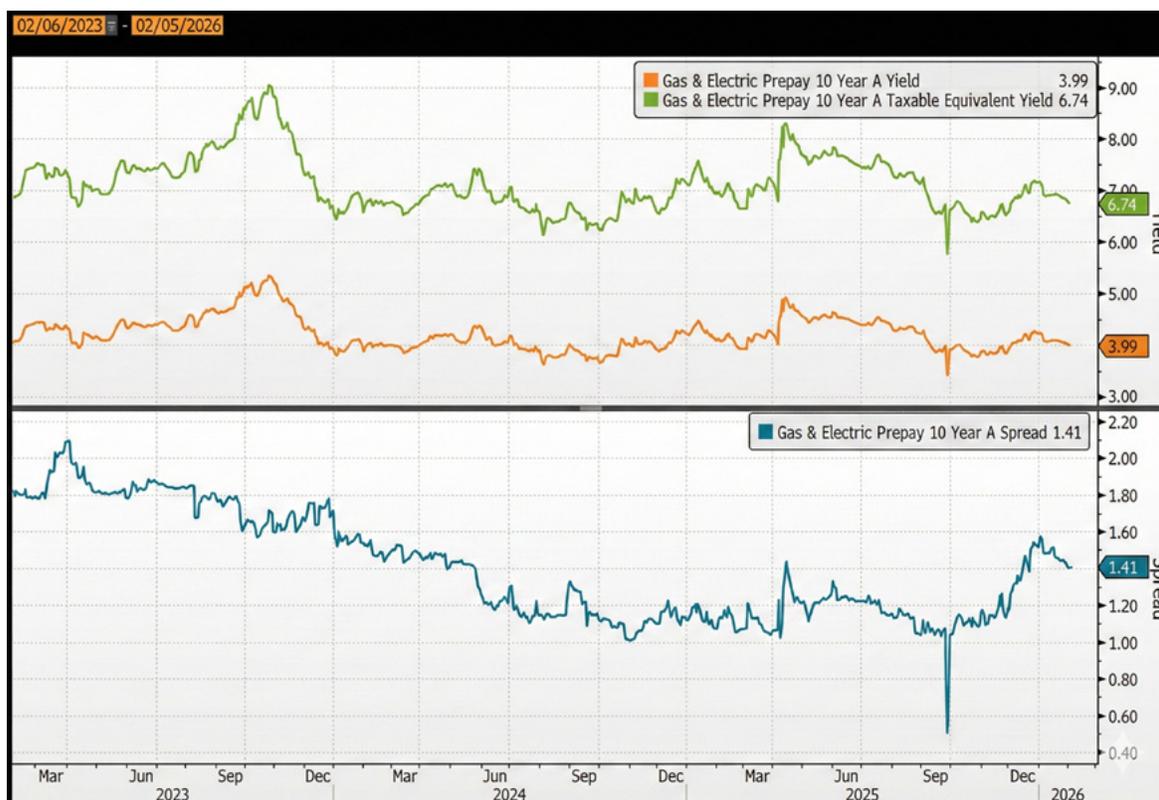


Source: Internal, Bloomberg as of January 2026

Where We Believe the Value Is Now

We believe there continues to be strong value in gas and electric prepay bonds. The sector exhibits high public ratings, strong liquidity, and transaction sizes that grow.^v Using a ten-year bond as a comparison over a three-year period, spreads have narrowed from a peak near 209 basis points in early 2023 to around 141 basis points as of February 5th. That level remains attractive both in absolute terms and compared to similar sectors. The current tax-exempt yield of approximately 3.99% translates to a taxable-equivalent yield of nearly 6.74% for investors in the highest federal tax bracket.^{vi}

Illustrating Value



Source: Bloomberg as of February 5, 2026

Recent market dynamics have caused a clear split in spreads. More participation from non-traditional funding recipients, especially insurance companies such as American National Insurance, American General Life, and Forethought Life Insurance, has resulted in differences of approximately 30 to 70 basis points compared to transactions with more traditional counterparties, such as Goldman Sachs, Morgan Stanley, and RBC. The structure of deals is also changing.^{vii} Investors are seeing more use of bullet maturities in a market that has historically preferred put bonds. As bullet issues have grown, the spread gap between bullet and put structures has begun to narrow, indicating a shift in demand and acceptance.^{viii}

Pricing, Correlation, and Terms

Prepay bonds combine commodity, credit, and rate factors. They may trade at a premium or discount compared to similarly rated essential service revenue bonds, depending on market perceptions of the structure's quality and the counterparty's strength. Correlations change with market regimes. When volatility increases or structural news emerges, pricing may shift to reflect added complexity.

Traditional final maturities place duration risk directly on the investor and compensate with yield. Call provisions can either safeguard or reduce value. Ledger event definitions can stabilize cash flows or accelerate stress under specific scenarios. Two prepay bonds with similar ratings may trade very differently because the scope of risk is broader than it appears. Investors who understand these mechanics have an advantage in both bond selection and managing credit risk.

Regulation and the Tax-Exempt Question

The regulatory history is embedded in the market's DNA. In 1999, the Internal Revenue Service expressed concern that prepays might be using tax-exempt financing to gain an unfair price advantage, causing the market to pause as rules were reevaluated. In 2003, the IRS clarified that prepay transactions could maintain tax-exempt status if utilities used at least 90% of the commodity for their own customers.^{ix}

The policy aimed to prevent pure profit-driven resale. In 2005, Congress clarified this with the National Energy Policy Act, which included provisions on arbitrage rules for natural gas prepayments.^x These measures did not eliminate all complexity, but set expectations for public purpose.

What We Believe Careful Investors Should Do

The prepay sector rewards a methodical approach. It starts with a counterparty review (e.g., off-takers and funding recipients), but it does not stop there. Investors should understand the basic creditworthiness of any swap providers and reinvestment providers. They should read how a ledger event is defined and triggered. They should study call language to match their own investment needs. They should ensure that security provisions align with the issuer's ability to perform, rather than relying on assumptions about guarantees. Most importantly, they should test how the structure performs under stress, including commodity shocks, counterparty deterioration, or legal / tax reinterpretations.

Our Closing View

Prepay bonds are not just a curiosity. They are an ever-growing component of public finance that has evolved in tandem with the needs of utilities, the capabilities of counterparties, and regulatory constraints. The sector calls for both caution and curiosity. Caution, because the structures are complex and unforgiving if misunderstood. Curiosity, because complexity can uncover opportunities for those willing and able to do the work.

The question for investors isn't whether prepay bonds belong in the municipal conversation. They already are. The real question is whether each transaction can be understood on its own terms, documented carefully, and sized with discipline. That's how the sector secures its place in portfolios. The old rule still holds. If you cannot explain how a prepay transaction works, you should not own it. Remember, the funding recipient does not guarantee the repayment of principal or interest on the bonds.





- i. [https://law.justia.com/codes/louisiana/revised-statutes/title-33/rs-33-4545-7/#:~:text=\(3\)%20The%20estimated%20useful%20life%20of%20such%20project.&text=\(5\)%20The%20reliability%20and%20availability,%C2%A7%C2%A7%20and%205.&text=Disclaimer:%20These%20codes%20may%20not,Please%20check%20official%20sources.](https://law.justia.com/codes/louisiana/revised-statutes/title-33/rs-33-4545-7/#:~:text=(3)%20The%20estimated%20useful%20life%20of%20such%20project.&text=(5)%20The%20reliability%20and%20availability,%C2%A7%C2%A7%20and%205.&text=Disclaimer:%20These%20codes%20may%20not,Please%20check%20official%20sources.)
- ii. The Bond Buyer (05.10.1996)
- iii. Bloomberg Municipal Bond Index as of 01.08.2026
- iv. Bloomberg Custom Map function
- v. Bloomberg Sector Issuance Detail as of 01.08.2026
- vi. Using a 40.8% tax rate (37% tax bracket + 3.8% investment income tax)
- vii. Bloomberg Sector Issuance Detail as of 01.08.2026
- viii. Bloomberg Sector Issuance Detail as of 01.08.2026
- ix. <https://naturalgasintel.com/news/municipals-returning-to-prepaid-supply-deals-of-late-1990s/>
- x. Section 1367 of the National Energy Policy Act of 2025

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