

Preferred Stock Update

2Q 2019 Yields Down 140 bps from 2018

John L. Varga, III, ASA

MPI is often called upon by clients and wealth advisors to provide expert opinions in the context of establishing preferred stock and preferred freeze partnership structures, or simply valuing existing preferred equity. In addition, with higher lifetime exclusion amounts through 2025 and the continued availability of the basis step-up at death, it has become paramount that wealth advisors contemplate structures that consider minimizing both the income tax and the estate tax.

Many advisors are currently discussing plans with their clients that involve preferred partnerships, enabling the client to freeze the asset value in their estate, allow for the basis step-up at death on the frozen assets, and move future appreciation into a trust by transferring the common equity. For example, this may be particularly useful for clients with low basis or negative basis real estate.

Given relevant federal tax rules and regulations, including the provisions of Internal Revenue Code Section 2701, it is critical that clients have a qualified team of professionals providing the appropriate support in these matters. MPI has the experience and expertise necessary to assist clients with preferred equity structures, and maintains databases and models to develop thoughtful opinions.

Preferred Stock Yields at June 30, 2019

Preferred stock continues to trade at yields below historical averages. Despite increases in benchmark rates by the Federal Reserve, on the whole, we continue to be in a low interest rate environment. Preferred stock is often viewed as a debt-like instrument due to its fixed dividend rate. This implies that preferred stock is valued and trades like debt, meaning increases in market interest rates may push preferred yields higher and preferred stock prices lower, and vice versa.

MPI conducted an update of its preferred stock database as of June 30, 2019, and compared general levels of interest rates to those observed on December 31, 2018. Interest rates and preferred stock yields have been low by historical standards, and may be heading lower in the coming periods. As shown below, the median preferred stock yield fell 140 basis points during this short period.

As of June 30, 2019, the median yield of the 184 publicly traded preferred stock issues that met MPI’s criteria for inclusion in its latest model was 5.4% using the yield-to-worst convention. The yields ranged from 2.8% to 7.9% for the middle 80% of the observations. The database includes preferred stocks from issuers in a variety of industry categories, including asset management, banking, capital markets, hospitality, insurance, oil and gas, real estate, telecommunications and utilities.

Prices of preferred stock for the most highly leveraged issuers traded at yields ranging between 4.7% and 8.6% for the middle 80% of observations. For clients considering various estate and corporate planning alternatives, these capital market conditions might warrant consideration of a preferred freeze structure. At other points in history, highly leveraged preferred stock traded at significantly higher yields.

Factors that seem to drive investors to demand higher or lower yields in today’s market include asset coverage, earnings coverage, the issuer’s total leverage, and the size of the issuing company. Weaker issues, such as those with lower asset and earnings coverage ratios, tended to trade at yields between 3.0% and 8.5% for the middle 80% of all observations.

In comparison, as of December 31, 2018, the median yield of the 180 publicly traded preferred stock issues that met MPI’s criteria for inclusion in the model on that date was 6.8%, or 140 basis points higher than at June 30, 2019. The yields ranged from 4.6% to 9.4% for the middle 80% of the observations. Further comparisons are contained in the table below:

MPI Preferred Stock Model: Summary of Recent Data						
Model Date	# of Issues	Median Yield	Percentile Yields		High Leverage	Low Coverage
			10th	90th		
12/31/2018	180	6.8%	4.6%	9.4%	7.4%	7.5%
6/30/2019	184	5.4%	2.8%	7.9%	6.1%	6.0%
Basis Point Chg. =>		-140	-180	-160	-130	-150

MPI regularly provides opinions to clients that are establishing terms for preferred stock and preferred freeze partnerships, or valuing preferred stock for transfer tax, income tax or corporate purposes. If you have any questions about the MPI Preferred Stock Model or our valuation and advisory services, please contact your local MPI representative.

About MPI

MPI, a prestigious national consulting firm founded in 1939, specializes in business valuation, forensic accounting, litigation support and corporate advisory work. MPI provides fairness opinions, sell-side and buy-side advisory services through its investment banking affiliate MPI Securities, Inc. MPI conducts every project as if it is going to face the highest level of scrutiny, and its senior professionals have extensive experience presenting and defending work product in front of financial statement auditors, management teams, corporate boards and fiduciaries, the IRS, other government agencies, and in various courts.

For additional information pertaining to MPI or MPIS and our valuation and advisory services, visit www.mpival.com

DISCLAIMERS: The information provided in this publication is only general in nature. It has been prepared without taking into account any specific objectives, financial circumstances or needs. Accordingly, MPI disclaims any and all guarantees, undertakings and warranties, expressed or implied, and shall not be liable for any loss or damage whatsoever (including human or computer error, negligent or otherwise, or actual, incidental, consequential or any other loss or damage) arising out of or in connection with any use or reliance upon the information or advice contained within this publication. The viewer must accept sole responsibility associated with the use of the material in this publication, irrespective of the purpose for which such use or results are applied. This material should not be viewed as advice or recommendations. This information is not intended to, and should not, form a primary basis for any investment, valuation or other decisions. MPI is not acting as a fiduciary, an expert or advisor in any capacity whatsoever in providing the information set forth herein. The information set forth herein may not be relied upon and is not a substitute for competent legal and financial advice. The viewer of this material is cautioned and advised to consult with his or her own legal and financial counsel in evaluating the information provided herein.

The information provided in this publication is based on public information. MPI makes every effort to use reliable and comprehensive information, but makes no warranties or representations of any kind relating to the accuracy, completeness or timeliness of the information provided herein and MPI shall not have liability for any damages of any kind relating to any reliance on such data. Further, the information set forth herein is continuously subject to change and may fluctuate. MPI has no obligation to update the information set forth herein or to advise the viewer when opinions or information may change.

Investment banking and transaction advisory services are provided by MPI Securities, Inc., member FINRA/SIPC. Persons affiliated with MPI Securities, Inc. are registered representatives of and securities are offered through MPI Securities, Inc. This publication is not a solicitation or offer to buy or sell securities. The information contained in this publication was prepared for information purposes only and was not intended or written to be used as investment or tax advice or as a recommendation to buy or sell securities.

For More Information Contact:

John L. Varga, III, ASA

jvarga@mpival.com

212-390-8374