MMA Independent and Data Driven

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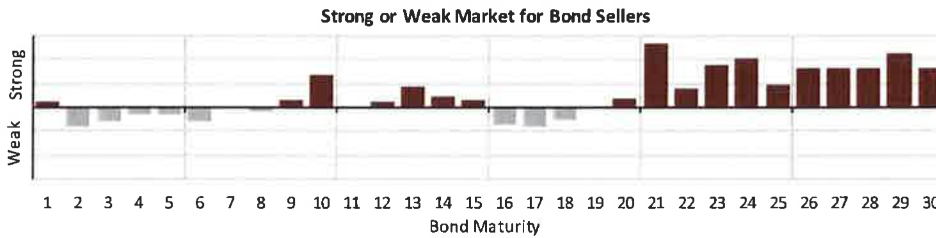
MUNICIPAL MARKET JOURNAL



MMA 5% AAA Benchmark

	8/19/2016	8/12/2016	Change
2-yr	0.52%	0.52%	0
5-yr	0.90%	0.90%	0
10-yr	1.45%	1.44%	1
30-yr	2.28%	2.28%	0

There were few distortions in the municipal curve over the past week, other than a relatively stronger evaluation present among longer maturities. The 10-year benchmark maturity has been within a 5 basis point range since July 14. Institutional fund demand continued to chase yield and thus longer and lower rated issues were more desired. Last week there was limited basis point change in MMA's 5% benchmark (available free on Bloomberg, CMMA <GO>).

MARKET UPDATE

A week of issuance above seasonal averages could challenge ability of underwriters to be aggressive ahead of next week's FOMC comments made from its annual gathering in Jackson Hole, WY.

HIGHLIGHTS

- Full on summer doldrums last week, with Fed minutes (uncertainty), a large new issue calendar, and a growing disruption of the municipal money market industry unable to push tax-exempt yields more than a basis point or two.
- According to ICI data, tax-exempt money market funds have lost over a third of their assets this year, including $21.6B in the last two weeks alone. Roughly three quarters of these latest losses were in retail funds, implying collateral damage from a shift to a floating NAV in institutional funds in October but perhaps more impactful has been the shift of individual assets to the record performing US equity markets. The Nasdaq has rallied nearly 10.0% in the last 3-months.
- In fact, the only area of performance last week was, once again, in the primary market, where key transactions—such as the Barclays Center (Baa3/BBB-/NR) refinancing—traded up strongly after sale.
- August issuance through August 26 is the greatest of any year since sub-prime crisis in 2008.
- Relatedly, primary dealers added nearly $2B of VRDOs to inventories in the week ended August 10 and likely added more last week. This reasonably limits banks' market making efforts elsewhere—i.e. away from fixed-income assets.
- Municipal money funds—contending with a rapid decline in supply—have also struggled to track a slowly rising LIBOR. Weekly VRDO resets are down 12% versus 2015 and 34% versus 2013, and reinvestment-stressed fixed rate investors have become less likely to part with stub securities. This helps explain why, despite demand concerns over the NAV, the 7-day SIFMA rate was as much as 10bps rich to 67% of 3-month LIBOR two weeks ago and 7.5bps rich last week. SIFMA's reset (4bps higher) to 50bps last week brought the gap to LIBOR to a more sustainable 5bps.
- These dynamics, along with the Fed, are likely to keep the front of the fixed rate curve relatively soft and term spreads thin, further encouraging investors—who at this point need little prodding—to drop into lower credits and coupons for incremental income.

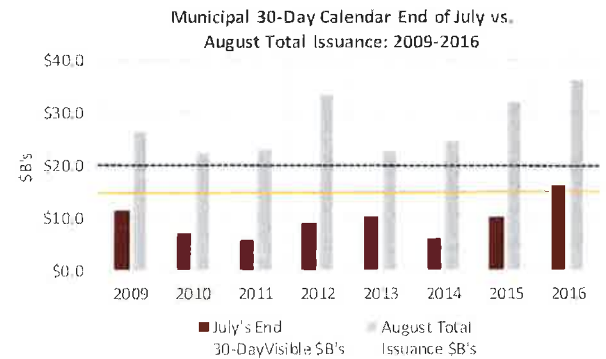


***Figure 1**: The large municipal 30-day visible supply total on July 29 suggested that this August would be the largest issuance since 2008. It is.*

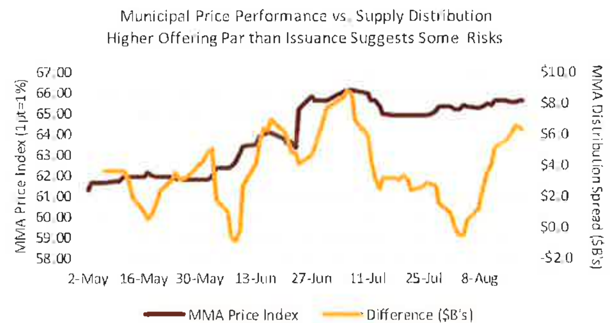


***Figure 2**: Amid a flat market condition, placement of issues has not been as vibrant as in July. Dealer inventories have increased in August (yellow).*

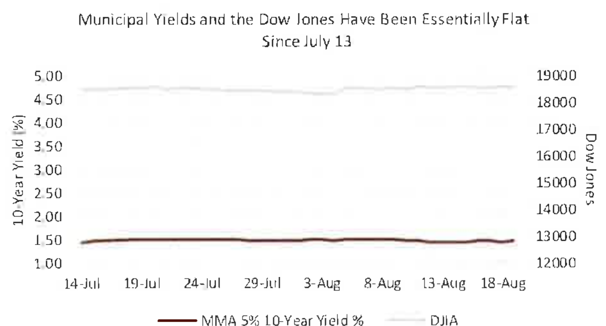


***Figure 3**: Since July 13, the 10-year municipal benchmark yield and the Down Jones have displayed little change or movement.*

DOWNGRADES PREVAIL IN AN OTHERWISE STABLE RATINGS ENVIRONMENT

Moody's rating activity was decidedly more negative in Q2 with downgrades accounting for 61% and dragging its YTD upgrade to downgrade ratio— which had been even in Q1—to below 1. Despite the more pessimistic activity, the underlying data shows that the rating agency is reacting largely to concentrated pockets of credit deterioration versus widespread trends. Three states have accounted for 41% of 2016 downgrade activity. Another positive factor, the agency's superdowngrades are on pace to be the lowest in 5 years.

So far in 2016, a little more than 4% of the agency's 12,300 ratings have been modified, meaning that the rest (most) have been stable. In recent years, the agency's activity has climbed to a high of 8.7% in 2015 from a low of 5.2% in 2011. This landscape should improve the perception of and help to restore confidence in the predictability of ratings, although actions related to methodology change remain a disruptive force and a challenge for investors.

States that have suffered most downgrades, had various reasons for stress:

1) State's with budget impasses have led to downgrades; and have resulted in many negative actions for other areas that saw their funding impacted by the stalemate — such as public higher education institutions.

2) Local credits with significant exposure to the oil and gas industry have been exposed to states' downgrade activity higher in the first half of 2016. Tax-base contraction and reduced economic activity as a result of low oil prices and reduced production activity have been the preeminent concerns.

3) School districts have continued to be an example for a segment of the broad municipal market that has faced unrelenting challenges. These credits have often been dependent on per pupil funding from the state. Enrollment declines related to population shifts (outmigration) and charter school growth have combined with sticky fixed costs to challenge school finances. Add in the limitations on a schools' ability to raise revenues and it's reasonable to expect that pressure on this portion of the market will not abate any time soon.

IMPACTFUL BOND DEALS AND ASSOCIATED TRADING

Below *are* ***four*** *new primary deals that have impacted the market recently with associated secondary trading dynamics:*

Brooklyn Arena Local Development Corp.

8/16: **Goldman, Sachs & Co.** priced $483M Barclays Center revenue refunding bonds for the **Brooklyn Arena Local Dev. Corp.**; Baa3/BBB-/NR; except bonds in 2029, 31-36 and 43 which are AGM insured (A2/AA/NR); callable at par in 1/15/2027:

Pricing Notes: Deal was very well received and bumped on re-price.

Maturity	Coupon	Yield	+/- AAA 5%
2021	5.00	1.54	+64
2026	5.00	2.22	+78
2036	3.00	3.07	+98

Secondary Trading: Bonds traded firmer in the secondary; specifically the 5s of 2026 traded 15bps better than original levels on Friday.

New Jersey Health Care Facilities Financing Auth.

8/16: **Morgan Stanley & Co.** priced $248M St. Josephs healthcare system obligated group revenue bonds for the **New Jersey Health Care Facilities Financing Authority**; Baa3/BBB-/NR; callable at par in 7/1/2026:

Pricing Notes: Structured with mostly 5%cpns, no repricing changes.

Maturity	Coupon	Yield	+/- AAA 5%
2021	5.00	1.54	+64
2026	5.00	2.33	+89
2036pc	5.00	2.96	+87

Secondary Trading: Bonds broke firmer in the secondary; the 4s of 2048 traded at 3.38% on Fri. vs 3.48% original levels.

Boston Water and Sewer Commission

8/16: **Bank of America Merrill Lynch** priced $146M general revenue and refunding bonds for **Boston Water and Sewer Commission**; Aa1/AA+/NR; Series A (below) is $60.6M callable at par in 11/1/2026:

Pricing Notes: Deal was structured with 5s on shorter maturities and a 3% coupon on the longer 2031 spot with a 10-yr par call.

Maturity	Coupon	Yield	+/- AAA 5%
6/2021	5.00	0.76	0
2021	5.00	0.91	+1
2031pc	3.00	2.47	+67

Secondary Trading: Bonds traded slightly firmer on secondary breaks. The 3s of 2046 traded 2bps better on Thurs. vs originals

Louisville & Jefferson County

8/17: In the competitive space, the Louisville $ Jefferson County Visitors and Convention Center, KY sold $138M dedicated tax revenue bonds to Bank of America Merrill Lynch; A2/A/NR; callable at par in 6/1/2026; the 30yr bond is insured by AGM:

Pricing Notes: No 5% coupons on any spot maturities.

Maturity	Coupon	Yield	+/- AAA 5%
2021	4.00	1.50	+60
2031	2.75	2.87	+106
2041	3.125	3.24	+101

Secondary Trading: Bonds broker firmer in secondary trading; the 4s of 2035 traded at 3.24% on Fri. vs 3.30% original yield.