MMA Independent and Data Driven

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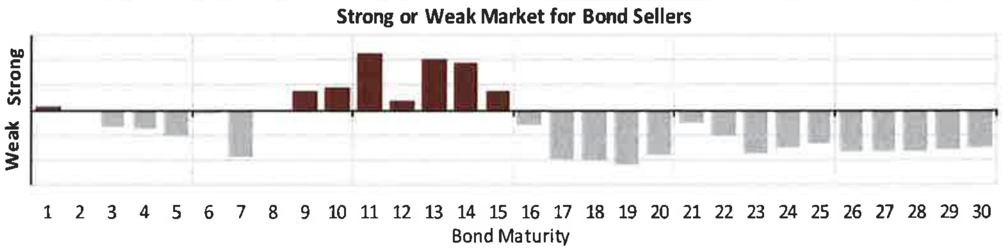
MUNICIPAL MARKET JOURNAL



MMA 5% AAA Benchmark

	9/12/2016	*9/5/2016*	*Change*
2-yr	0.68%	0.64%	4
5-yr	0.99%	0.91%	8
10-yr	1.53%	1.47%	6
30-yr	2.34%	2.29%	5

Except for the 10-15-year range, the rest of the municipal yield curve is showing as mostly "weaker", implying that buyers have some reasonable potential for gains and issuers may experience a more concessionary environment if pricing a deal this week. This scenario may be less prevalent at the very front of the curve given recent re-pricing to cheaper yields, implying more relative attractiveness for buyers up front.

MARKET UPDATE

Risk of a larger correction is growing at the long end of the municipal yield curve.

HIGHLIGHTS

- Federal Reserve governors' statements, higher yielding global bond markets, and the elevated volatility in high current bond prices all helped U.S. Treasuries sell off with stocks last Friday. Treasuries finished the week 12 basis points cheaper (i.e. higher in yield) at the 30-year but 1 basis point richer (i.e. lower in yield) at the 2-year. The 30-year long bond is now at pre-Summer, pre-Brexit yield levels.
- Tax-exempts also experienced similar weakness as US Treasuries, with municipal yields rising as much as 5 basis points amid relatively heavy trading for a Friday. But the municipal curve did not "bear steepen" (i.e. higher yields along a steeper yield curve) as aggressively (**Figure 1**).
- This is consistent with relative performance trends. Mutual fund inflows actually appeared to accelerate last week, with estimated inflows, according to ICI, of $1.5B that brings YTD inflows to nearly $50 billion. With last week already featuring a holiday-reduced primary market calendar, elevated fund inflows were a key driver of outperformance (**Figure 2**).
- Still, the municipal curve's long-end has more at risk in the weeks ahead given its heavy reliance on mutual fund inflows, and not having corrected as aggressively as early maturities (where money fund regulation has been more disruptive).
- The SIFMA 7-day municipal floating rate is now the highest yield it has been relative to 3-month LIBOR since 2Q11. In other words, the municipal front end—depending in part on this week's Federal Reserve language—should begin to attract buyers for the first time in months. Note that primary dealer inventories of VRDOs actually shrank on August 31 for the first time since August 3, alleviating balance sheet pressure which is a positive sign for a heavy forward calendar that surpassed $18B this morning (**Figure 3**).

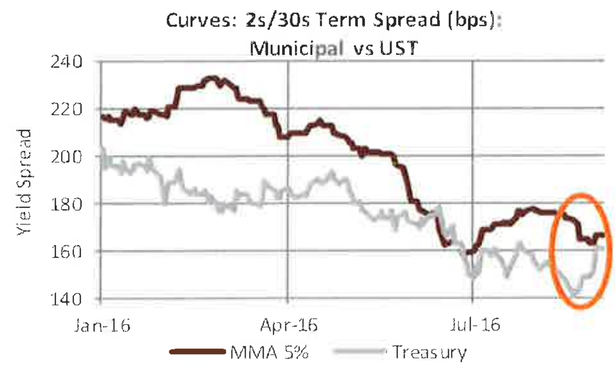


Figure 1: Municipal yield spreads between 2 and 30 years did not increase at the same pace as Treasury yield spreads.

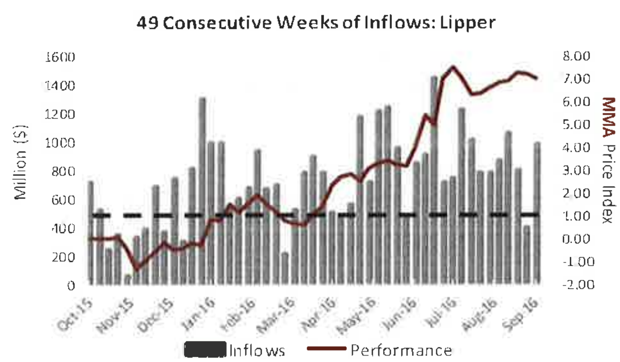


Figure 2: Mutual funds continued to be a consistent buyer of new issue, a persistent and key driver of demand.

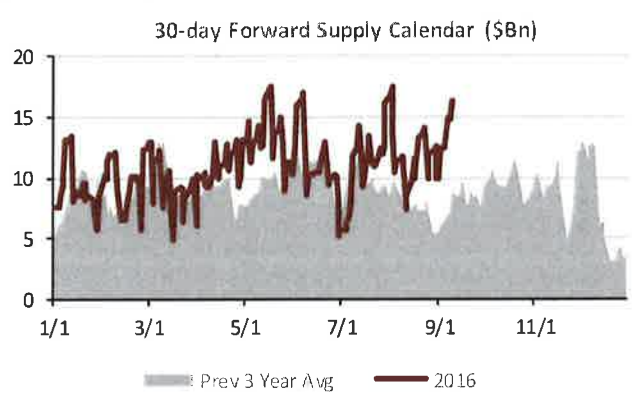


***Figure 3:** Forward calendar has grown well above recent historical levels.*

PHILADELPHIA AND FEDERALISM

PHILADELPHIA AND FEDERALISM: Last week Moody's switched Philadelphia's A2 GO rating outlook to negative, citing the city's thin and thinning reserves and its unfunded pension liabilities. Although the city's population, economy, and tax receipts are all growing reasonably well—at least for a Northeast city—and although management is fairly sophisticated and financial transparency and oversight (via the PICA law) is quite strong, Moody's opinion is hard to dispute. Philadelphia's credit profile contains a fair degree of long-term risk and enough political friction to make basic management advice difficult to implement. Still, that advice is aimed at reducing the city's reliance on what have been, and will be, poor state and Federal partners, and includes directions to:

1. ***Rebuild reserves to acceptable levels.*** Current General Fund reserves are approximately 2% of expenditures and actually decline over the next few years before rising with a projected deposit in 2020. Because the city relies on more economically sensitive taxes like the wage tax, higher reserves are critical protections for city stakeholders and service recipients. Note that reserves are an increasingly important rating driver as methodologies become less locally flexible and more metric driven. Thin reserves thus expose the city to more immediate and potentially harsher (super-) downgrades should economic conditions erode, state aid cuts materialize, or new Federal challenges emerge.

2. ***Stop cutting tax rates.*** The city has been steadily reducing the rates on its unpopular wage tax and business income and receipts tax to encourage investment and job growth. This is a reasonable strategy in the near term; however, long-term state aid reductions and new unfunded Federal mandates are highly likely, in **MMA's** opinion. This is, we reason, an unavoidable byproduct of slow American economic growth, and **all municipal governments will be challenged to maximize local revenue flexibility as higher levels of government extract downstream resources for their own benefit**. Further, long term Federal and state tax rates are very likely to rise, potentially crowding out local government taxing authority.

IMPACTFUL BOND DEALS AND ASSOCIATED TRADING

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

Austin, TX

9/7: **Wells Fargo Securities** priced $187M public improvement bonds, certificates of obligation, and public property finance obligations for **Austin, TX**; Aaa/AAA/AAA; callable at par in 9/1/2026:

Pricing Notes: Bonds were re-priced with mixed adjustments; shorter maturities were cut while longer maturities were bumped.

Maturity	Coupon	Yield	+/- AAA 5%
2021	5.00	1.10	+16
2026	5.00	1.60	+14
2036	5.00	2.24	+16

Secondary Trading: New issue tickets printed on Thursday, but institutional trading has been limited since issuance.

Washington

9/7: **Washington** sold $134M general obligation bonds to **Citigroup Global Markets Inc.**; Aa1/AA+/AA+; callable at par in 8/1/2026:

Pricing Notes: Citigroup won the bonds with a true interest cost of 2.9969%.

Maturity	Coupon	Yield	+/- AAA 5%
2021	5.00	1.04	+10
2026	5.00	1.63	+17
2041	5.00	2.33	+10

Secondary Trading: On Friday, the 5s of 2041 traded 8 basis points weaker than originals (2.41% vs. 2.33% orig.).

DASNY

9/8: The **Dormitory Authority of New York** sold $295M personal income tax revenue bonds to **Bank of America Merrill Lynch**; Aa1/AAA/NR; callable at par in 8/15/2026:

Pricing Notes: Bank of America won the deal with a true interest cost of 3.49%.

Maturity	Coupon	Yield	+/- AAA 5%
2037	5.00	2.28	+15
2041	5.00	2.32	+9
2046	4.00	2.63	+35

Secondary Trading: Trading has been limited, but bonds from the issuer's other offering broke into the secondary at higher yields.

DASNY

9/8: The **Dormitory Authority of New York** sold $243M personal income tax revenue bonds to **Citigroup Global Markets Inc.**; Aa1/AAA/NR; 2027-2036:

Pricing Notes: Citigroup won the bonds with a true interest cost of 2.84%.

Maturity	Coupon	Yield	+/- AAA 5%
7/2021	5.00	1.05	+15
2026	5.00	1.66	+21
2028	2.00	2.17	+53

Secondary Trading: On Friday, 5s of 2035 traded 8 basis point weaker than originals (2.27% vs. 2.19% orig.).