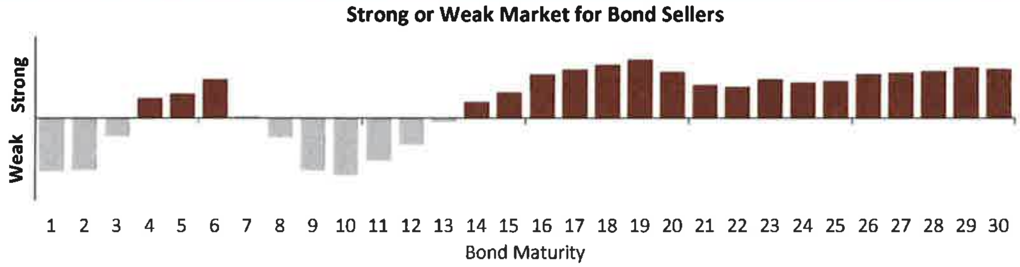
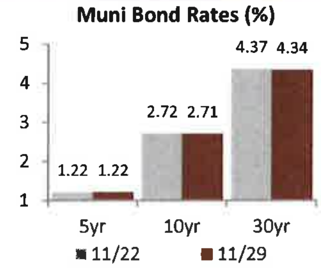
MMA The Power of Independence

DECEMBER 2, 2013

MUNICIPAL ISSUER BRIEF





Heading into this week, the current market dynamic continues to generally favor issues selling bonds 12-years and longer. The demand in the 4- to 7-year range continues to be the result of demand from separately managed accounts on this part of the yield curve. The 10-year remains difficult.

MARKET UPDATE

MARKETS TOOK A BREAK FOR THANKSGIVING: Last week was a slow one for most markets. This was to the advantage of state and local governments as the quiet pace helped market participants take a breather from recent volatility.

INVESTORS & ISSUERS: Only three business weeks left this year.

- **Markets slowed to a crawl last week**. Only a handful of municipal issuers came to market (about $650 million total).
- **This week things will pick back up in a hurry.** Not only is there a big uptick issuance but also on Friday all markets will digest the last monthly employment data for the U.S. This data has proven to be a market-mover as it has implications as to when the Federal Reserve will begin to slow its bond-buying program that has kept interest rates low since the financial crisis.
- **November saw a 10% drop in municipal issuance versus October's volume.** This decline is consistent with the historical relationship between the two months. The 31% decline relative to November 2012 is reflective of weakened demand component as compared to a year ago.
- **Two weeks ago bankrupt Jefferson County, Alabama sold nearly $2 billion sewer revenue bonds**—one of the largest junk-rated deals in municipal history. Since then, many of the bonds have traded significantly cheaper, making investors possibly war of other lower-rated deals.. Last week, funds that buy lower-rated bonds lost a significant amount of cash, which could make this week's large volume of lower-rated new deals difficult.
- **Positive news on Illinois' pension should be good for the state's bonds broadly—although major hurdles remain.**

BUYER BITES:

WHAT IS TRENDING HOT:
1) Puerto Rico bonds
2) High-grade competitive deals
3) Illinois GO/pension obligations

CURRENTLY HARDER SELLS:
1) Mutual funds
2) Jefferson County sewer bonds
3) Non-investment grade in general

WHO IS REPORTEDLY BUYING:
Separately managed accounts, regional/community banks, non-traditional buyers out long

MUTUAL FUNDS

- The latest weekly data of the cash that mutual funds have to invest in municipal bonds reported that individuals pulled yet another $1 billion out of funds. **Figure 1** demonstrates just how bad 2013 has been for these buyers. Until mutual funds can overcome investors pulling out, issuers should consider other buyer-types and how to market to them.

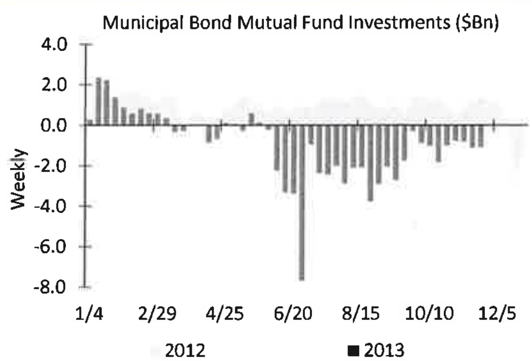


Figure 1: *In 2013 thus far, mutual funds that buy municipal bonds have lost more than $50 billion in cash, including an on-going streak of 26 weekly losses that is the largest ever. The darker grey bars show each week's new data—when it is below the horizontal line they are cash losses. The lighter grey is last year's positive data.*

TOPIC OF THE WEEK: SPLIT RATINGS

RATING AGENCIES: This September, **Stratford, Connecticut** sold $16 million of general obligation municipal bonds. What makes this sale of particular interest was that ahead of issuance **Moody's Investors Service** downgraded the city's GO debt (to A1 from Aa3) while **Standard & Poor's** upgraded (to AA from AA-minus) the same debt. Behind Moody's move was the "town's severely underfunded pension plan." Meanwhile, in S&P's opinion, an upgrade was merited due to its "very strong economy, which benefits from participation in the broad and diverse economies" of other close local governments. ***MIB*** discussed in October the revised criteria being used by the two rating agencies that has contributed to diverging rating trends. This is likely to lead to an increase in split ratings for municipal issuers, meaning that the set of ratings don't match up. In other words, Stratford is not alone.

WHAT THIS MEANS FOR YOU: First, issuers and their advisors should take care to understand what is driving rating actions under the updated methodologies to see whether they are facing potential rating actions that could be in different directions. Second, with an increasing number of split ratings, bond investors are relying less on ratings and more on their own internal credit research. This exposes issuers to a broader array of credit-related concerns outside of traditional factors like pension funding, population trends, state oversight and continuing disclosure practices. To the extent diverging opinions make your credit profile more ambiguous, the role of non-credit-related factors (like the total size of a bond issue, or the specific coupon attached by your underwriter) grow in importance to investors. The bottom line here is that municipal bond issuers may need to spend more time discussing their credit position directly with investors versus relying on the assigned rating to be sufficient on its own. A demonstrated commitment to ongoing communication with investors on key credit issues will help you to achieve the most favorable borrowing cost, even in a period of greater rating uncertainty. Finally, and perhaps the biggest shift, municipal advisors may suggest issuers only purchase one rating—saving them money and avoiding investor confusion that split ratings cause.

ISSUER GROUP ROUNDUP

NASBO Releases Expenditure Report: In late November, the National Association of State Budget Officers (NASBO) published their annual *State Expenditure Report*, noting that for the first time in the report's 26-year history, state spending decreased in fiscal 2012, although rebounded to a positive trend in fiscal 2013. The fiscal 2012 decline can be assigned to the 9.1% decrease in federal funding to states, which wiped out the modest state general fund spending increases. NASBO noted that in FY13, expenditures returned to more normal levels, with modest increases. The report also discussed the remaining uncertainty and concerns related to federal funding to states' overall budget pressures in its short- and long-term outlook.

NACo Local Property Markets Survey; Beltway Threats: The National Association of Counties (NACo), in conjunction with Thomson Reuters, produced its annual Local Market Property Markets Survey. The 2013 survey showed that a majority of counties surveyed had an increase in assessed property values and an increase in records processed. The report concluded that this data indicated that the economic recovery has taken hold in the property markets. Meanwhile, NACo's Executive Director, **Matt Chase**, told NACo's members they needed to keep focused on Washington activities, noting a "triple threat" coming from Washington—tax reform, entitlement reform (specifically Medicaid funds to states and counties), and the effects of sequestration.

Related to the NACo comments on Washington activities: **MMA** believes the prospects for actual passage of fundamental tax reform remain low, with Congress likely unable to agree on anything substantive before the mid-term elections. The largest risk from tax reform at present is not in a sweeping bill, but in the mid-December negotiations of the bipartisan budget committee focused on replacing all or part of next year's sequestration-related spending cuts. Democrats have already announced an intention to consider removing tax-expenditures to afford higher spending, and Republicans to prevent any tax hikes. Still, the CBO recently published a list of solutions for funding sequester-cut spending, including removal of the tax-exemption for private activity bonds (PABs). The office calculated a $31B, 10-year Federal revenue savings if new PAB sales were fully taxable starting in 2014. Remember that the House Ways & Means bill reportedly also contains (or at least contained) a provision to remove the exemption for PABs. So while the chance of major changes continues to be fairly low we do see some at least rhetorical risk to PABs over the next few months. **MMA** will revisit Washington topics in the future.

REGIONAL BOND ISSUES (Moody's/S&P/Fitch)

NORTHEAST

On November 26th, **JPMorgan Securities LLC** bought $59 million of general obligation bonds from **Westchester County, New York;** NR/AAA/NR; callable in 7/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2018	5.00	1.01	-21
2023	5.00	2.58	-14
2027	4.00	3.32	-9

Notes: 2.58% yield in 10-years showed big demand in this maturity.

TERRITORIES

On November 20th, **Citigroup Global Markets Inc.** priced $176 million of water and wastewater system revenue bonds for the **Guam Waterworks Authority;** Ba1/A-/BB; callable in 7/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2023	5.25	4.45	+177
2028	5.00	5.125	+162
2033	5.25	5.375	+145

Notes: Triple-exemption of Guam still prompts demand.

MIDWEST

On November 20th, **Piper Jaffray** priced $160 million of Memorial Group, Inc. Hospital revenue bonds for the **Southwestern Illinois Development Authority;** NR/BB+/NR; callable in 11/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2023	6.00	6.25	+357
2033	7.00	7.40	+333
2043	7.25	7.625	+320

Notes: Junk rating with many long-dated maturities made this hard.

SOUTHEAST

On November 26th, **JPMorgan Securities LLC** bought $85 million of state economic development bonds from **South Carolina**; Aaa/AA+/NR; non-callable:

Maturity	Coupon	Yield	+/- AAA 5%
2014	2.00	0.17	-7
2018	5.00	1.13	-9
2023	5.00	2.63	-9

Notes: High-grade competitive issues stabilized yields.

SOUTHWEST

On November 25th, **Bank of America Merrill Lynch** priced $37 million of unlimited tax and revenue bonds for the **Dallas County Hospital District, Texas**; NR/AA+/AA+; callable in 8/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2018	5.00	1.35	+13
2023	5.00	3.06	+34
2033	5.00	4.28	+29

Notes: A stronger market and coming on a quiet Monday helped.

NORTHWEST

On November 21st, **JPMorgan Securities LLC** priced $102 million of state capital project bonds for the **Alaska Housing Finance Corporation**; NR/AA+/AA+; callable at par in 12/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2018	5.00	1.35	+14
2023	5.00	3.08	+39
2033	5.00	4.33	+38

Notes: Infrequent issuer plus a stronger market improved rates.