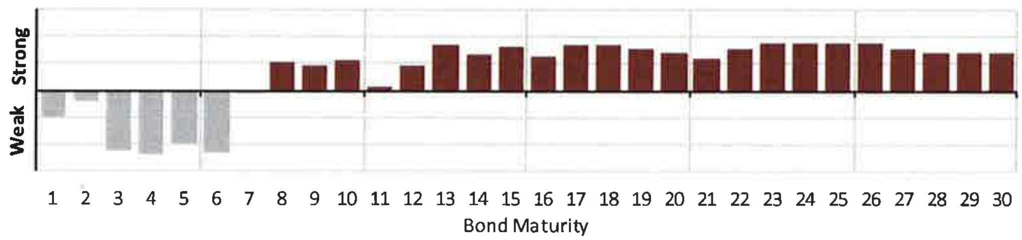
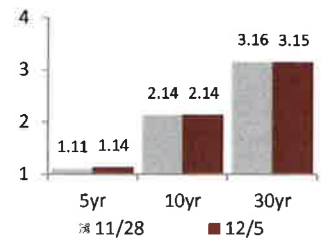
MUNICIPAL ISSUER BRIEF

Strong or Weak Market for Bond Sellers



Muni Bond Rates (%)



Heading into this week, after the last month's more mixed tone, a strong pricing dynamic has emerged almost entirely across the yield curve as positive themes developed throughout last week. We do caution that the shorter maturities have moved weaker—largely as a result of Friday's employment report.

MARKET UPDATE

MUNICIPALS OPEN WEEK WITH MIXED TONES: After a generally successful week, last Friday saw the tides turn when taxable bond markets sold off in response to a higher than expected U.S. jobs creation report. This makes for a mixed tone starting today.

INVESTORS & ISSUERS: Very large new-issue week handled well

- Last week saw the largest volume of municipal bonds priced in more than 2 years. **There was consternation amongst market participants as to how it would be digested but in large part,** most new-issues found stronger investor subscription—albeit on many of the larger deals, yields were higher than where those same bonds had traded in secondary markets of late.
- **This was in part because of continued balances on behalf of the dealer community**—learn more about this ***in last week's MIB.***
- Even much-beleaguered New Jersey was able to sell competitively with 8 bidding firms, though **yields were cheaper** than the last time it came to market (see ***Figure 1***, right, for more on this).
- Last Thursday when the brunt of the deals were priced, **MMA** noted a positive context, inclusive of **large retail participation in the market**—***contact us for a full review of this trading day*** — which may be of particular interest if coming to market now.
- The aforementioned positive momentum was dashed on Friday morning when the Labor Department reported the most job creation in November dating back to 2012—this led to a **sell off in Treasury bonds** and tax-exempts were under pressure.
- The market could be challenged under the weight of Treasury bonds in addition to another very large new-issue slate this week
- There are several high-grade issuers out of California that **MMA** will monitor as a sign of how new deals are faring, **in particular the Los Angeles CCD and Bay Area Toll Authority**.
- Also, remain aware European sovereign debt markets have seen extraordinary strength of late, and if should this continue it **would be expected to help municipal issuers this week**.

TAX REFORM LESS LIKELY: Incoming US House of Representatives Ways & Means Chairman **Paul Ryan** will not pursue comprehensive tax reform in the next two years. However, he did say corporate tax reform will be a focus. At the CEO Council (link here) he said: "a sweeping overhaul of the tax code would be nearly impossible because the Obama administration..." Note for 2011 the IRS listed corporations subject to corporate reform as holding $1.7 trillion tax-exempt securities, many of which are municipals. Meaning, if corporate reforms takes place, it could negatively impact these investors.

BUYERS BITES:

WHAT IS TRENDING HOT:
1) IG Healthcare
2) World Trade Center Bonds
3) Longer California GO

CURRENTLY HARDER SELLS:
1) New Jersey GO
2) New York TFA, Water Financing revenues

WHO IS REPORTEDLY BUYING:
Mutual funds, SMA, individuals, large banks

State GO Trades Last Thursday Vs. MMA 5% AAA Benchmark

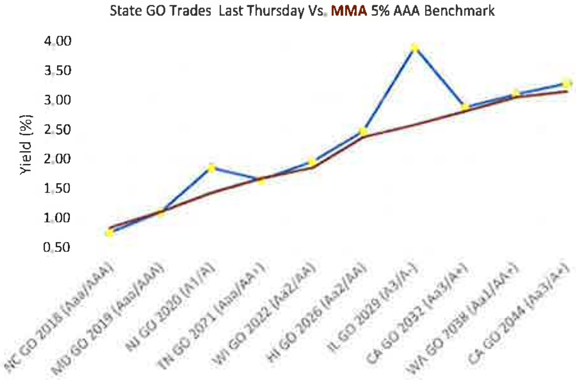


Figure 1: *The chart above compares various state GOs that traded in large volumes on Thursday (blue line, yellow circles), to the* ***MMA 5% AAA Benchmark*** *in the corresponding maturities (maroon line). Note how New Jersey and Illinois are trading higher in yield than the benchmark as the market has penalized each state for budgetary and pension woes. Additionally, note how California, which only has 1– or 2-notch rating differences from NJ and IL, is not being penalized by the market. The consensus is that the state is well on its way to a strong recovery. With the GO trading strongly, this week's big slate of issuers within California stand to benefit from the state's favorable context.*

TOPIC OF THE WEEK: ALTERNATIVES TO TRADITIONAL FINANCING

ALTERNATIVES TO TRADITIONAL MUNICIPAL FINANCING: Earlier this fall at the **California Debt and Investment Advisory Commission**'s conference, a panel addressed new sources of capital and alternative financing structures that are becoming more common in the municipal sector. These new sources differ from traditional long-term municipal debt issuance. Most notably, direct loans have emerged as both 1) a replacement for letter-of-credit and liquidity facility-supported variable-rate demand obligation (VRDO), and 2) as an alternative to capital market financing. (this MIB for more on direct loans.) Growth in this product has accelerated in recent years and is estimated to make up as much as 20% of new market issuance in 2014.

Issuers should be aware of not only the benefits but also the potential risks associated with any new financial product. Furthermore it should be determined whether the alternatives are a good fit for their entity. For instance, products that are suitable for a highly rated university with ample liquidity may pose untenable risks, such as acceleration, to a similarly rated local government.

WHAT IT MEANS FOR YOU: Here is a checklist of some of the items that should be addressed when determining if these financings are right for your entity.

1. **Structure Familiarity**. It may be helpful to start by comparing a new structure to one that you are familiar with, such as traditional, level-amortizing fixed-rate debt. How do the terms of the financing differ and are the products being used by similar entities? Is there a particular investor demand for these products?
2. **Internal Policy**. Does your debt policy or other financial policies allow for the use of this type of financing? Are there benefits that your government can derive from this product that are different or better than more traditional financings?
3. **Risks.** What was the impact on issuers using the product? Has the product been tested under adverse conditions? Have you run various scenarios on best and worst case theoretical outcomes you may experience?
4. **Additional Enhancements**. Does the product, for example a VRDO, require your entity to purchase a separate support product, such as a letter of credit or swap? The cost of the enhancement should be included in calculations related to the true lifetime costs of the product. Further, the terms and conditions of the various agreements, particularly the triggers for various circumstances related to the issuer, the counterparty, or market conditions, should be well understood.
5. **Staff Education and Monitoring**. Does the product require – and does your entity have – the knowledge necessary and ability to monitor the risks that are inherent in the financing?
6. **Disclosure Obligations**. Issuers should consider disclosing these products. Posting information to EMMA about the engagement in these products, and how they may affect current bondholders, should be incorporated into disclosure policies and procedures. An example is California's new law, that requires its issuers to disclose bank loans.
7. **Rating Agency Assessment**. Rating agencies are very keen on knowing the obligations an issuer is taking on regardless of the financing's structure. They expect that this information is provided when the financing is being consummated, not just when being formally reviewed (new-issue or surveillance). For instance, while there is no federal law requiring an issuer to specifically disclose the use of a bank loan, failure to communicate this information with certain parties, including Standard & Poor's, can lead to a negative rating action.
8. **Regulatory & Legislative Activity**. The federal government, through regulatory or legislative means often regulates new financial products, as we saw in the aftermath of the financial crisis, which can lead to increased costs to issuers. For example, bank agreements that have historically contained provisions that allow the bank to pass on costs to the issuer associated with a change in the regulatory or legal system, or in a bank-supported VRDO, if the bank cannot pass along its increased costs to the issuer it may elect to terminate its liquidity agreement. The ending of the agreement may result in a purchase of bonds by the bank and repayment to the bank of any amounts due more rapidly than required under the bond documents. On the legislative front, a recent example is the reduction of the subsidy rate for Build America Bonds due to sequestration. An entity should consider and monitor the likelihood of federal government action related to a financial product.

ALTERNATIVE INVESTMENTS:

Direct loans/purchase: Private financing directly between the issuer and lender (such as a bank)

Floating-rate notes: Variable rate financing in which the interest is tied to a benchmark rate

Put bonds with no external liquidity: Financing in which the investor has the right to tender the bonds to the issuer at one or more specified intervals

Public-private partnerships: A project or enterprise that is funded and operated through a partnership between a government and one or more private companies

Extendible CP or bond: Financing in which either the issuer or the investor has an option to extend the maturity of the debt

Century bonds: Bonds that mature in 100 years

Municipal guaranteed bonds: Bonds in which a municipality guarantees repayment of some or all of the debt of a third party

Vendor financing: Wherein the vendor provides a new service for no upfront fee; the government pays for it through regular rates and charges over the life of the improvement

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

NORTHEAST

12/3: **New Jersey** sold $525M general obligation bonds to **Bank of America Merrill Lynch**; A1/A/A; callable in 6/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.50	+39
2024	5.00	2.58	+45
2034	4.00	3.68	+75

Notes: This deal came at concessions reflecting recent downgrades

MID-ATLANTIC

12/3: **PNC Capital Markets** priced $96M bonds for **Commonwealth Financing Authority, Pennsylvania**; A2/A+/A+; callable in 6/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.50	
2024	5.00	2.75	
2034	5.00	3.61	

Notes: One of many healthcare deals last week that saw demand

MIDWEST

12/3: **KeyBanc Capital Markets** priced $137M various purpose sales tax revenue bonds for **Cuyahoga County, Ohio;** Aa1/AAA/NR; callable in 12/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	2.00	1.22	+11
2024	5.00	2.26	+13
2038	4.00	3.61	+55

Notes: The +13 spread in 10-years reflected a challenging market

SOUTHEAST

12/4: **Barclays Capital Inc.** priced $255M Health First Inc. revenue bonds for the **Brevard County Health Facilities Authority**; A3/A-/NR; callable in 4/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	3.00	2.10	+96
2024	5.00	3.34	+113
2044	5.00	4.29	+109

Notes: This issue saw bonds trade better in the secondary market

SOUTHWEST

12/2: **Piper Jaffray** priced $168M unlimited tax general bonds for the **Alvin Independent School District, Texas**; Aaa/NR/AAA; (PSF guaranteed); underlying Moody's: Aa2; S&P: AA; callable in 2/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.10	+
2024	5.00	2.20	+
2039	5.00	3.11	+

Notes: Investors continued to seek out Texas school district bonds

FARWEST

12/2: **The Los Angeles County Metropolitan Transportation Authority** sold $140M Proposition A first tier senior sales tax revenue bonds to **Wells Fargo Securities**; Aa2/AAA/NR; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.00	-11
2024	5.00	2.05	-8
2034	4.00	3.23	+30

Notes: One of several well-bid high-grade issues last week

SEC DISCLOSURE REPORT

SEC REPORT ON CONTINUING DISCLOSURE: The Securities and Exchange Commission (SEC) released for comment an estimate of the time it takes issuers and broker-dealers to prepare and submit tax-exempt bonds' primary and continuing disclosure materials as part of the federal government's Office of Management and Budget initiative to determine the compliance costs associated with all federal regulations. Issuers can submit comments to the SEC about what you believe the actual time and costs associated with complying with Rule 15c2-12, prior to the January 16, 2015 deadline.

The SEC estimates the following (on an annual basis):

- Issuers spend 45 minutes to prepare and submit continuing disclosure materials;
- Issuers take 45 minutes to prepare and submit material event notices, and another 30 minutes to prepare and file failure to file notices;
- Many issuers (65%) may use dissemination agents to help comply with their disclosure responsibilities at a cost of $750 per issuer;
- Broker-dealer firms spend 300 hours a year to comply with the Rule; and,
- The MSRB (through EMMA), spends 9,360 hours to run their system.