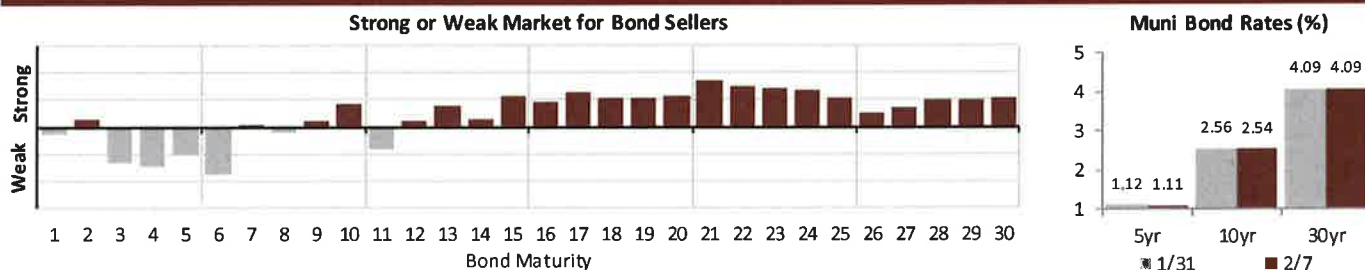


MUNICIPAL ISSUER BRIEF



Heading into this week, the strong dynamic for issuers generally on bonds maturing in 10-years and longer continues as supply is outweighed by demand. There is still resistance in certain shorter maturities and issuers should be especially vigilant when issuing bonds in this timeframe.

MARKET UPDATE

BETTER FOOTING TO START THE WEEK: A weak job creation report on Friday put most bond markets into lower interest rates last week. With minimal issuance this week (and likely next) the demand/supply dynamic favors most issuers.

INVESTORS & ISSUERS: This week starts off more stable.

- **The municipal market was able to withstand headwinds from other bond markets.** For most of the week other bond markets traded cheaper but municipals generally held their ground.
- On Friday, economic data showed less job creation nationally in January, **which caused most bond markets to rally**—a good sign for issuers coming into this week as municipal yields will be inclined to follow broader interest rates lower.
- **The supply picture continues to be extremely favorable for issuers.** So far this month, weekly issuance is roughly \$3 billion—a very low figure. **Figure 1** to the right shows how low current new-issuance has been in a historical context.
- **Illinois was able to successfully sell \$1 billion of GOs last week.** The deal had as much as 7 times more orders than there were bonds and was able to lower yields subsequently. The market has rewarded the state recently for its government's (preliminary) efforts to resolve its pension woes. We do note that today the bonds were trading as much as 17 basis points better in secondary markets implying savings lost.
- **Mutual funds lost investors last week**, reversing a mildly positive trend of inflows for the previous 3 weeks.
- **Nonprofit hospitals have seen yields increase so far this year.** This may be the result of hospitals adopting healthcare reform. Last week, **Wells Fargo** said in a report that they expect hospitals to underperform the rest of the market. Hospital issuers could see higher borrowing costs as a result.

BUYER BITES:

WHAT IS TRENDING HOT:

- 1) Short-call structures
- 2) Illinois GO
- 3) 10 to 20 year range

CURRENTLY HARDER SELLS:

- 1) Mutual funds
- 2) Puerto Rico
- 3) Non-profit hospitals

WHO IS REPORTEDLY BUYING:

Large banks, life insurance companies, SMAs

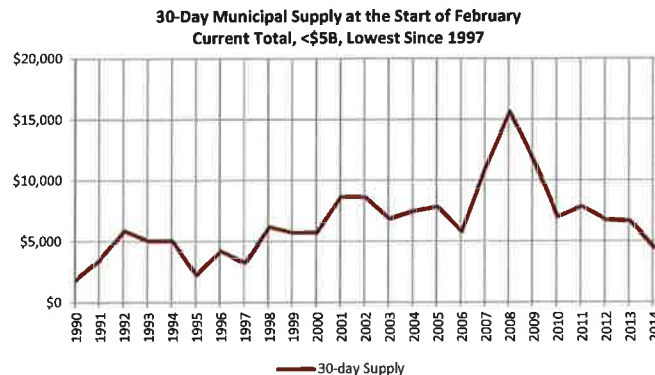


Figure 1: The red line above tracks **The Bond Buyer 30-day Visible Supply**. This is a metric used by market participants to gauge how many new-deals are scheduled to come to market in the next month. In this chart, we look at where the Visible Supply was at the start of February going back to 1990. So, this year the supply picture is at its lowest dating back to 1997.

PUERTO RICO DOWNGRADED: Last week **Moody's Investors Service** and **Standard & Poor's** downgraded a large portion of Puerto Rico's \$70 billion of outstanding bonds to non-Investment Grade. This is a major event for all issuers in the municipal bond market as it is a negative headline to overcome but also roughly 70% of all mutual funds own bonds issued by the territory. How the funds manage their holdings going forward could affect borrowing costs for all issuers. A review of the market impact on Puerto Rico over the last year is seen in **Figure 2** on **page 2**.

TOPIC OF THE WEEK: ISSUE PRICE REGS UNDER SCRUTINY

UPDATE ON ISSUE PRICE: The U.S. Treasury and Internal Revenue Service (IRS) held a hearing last week on their proposed updates to arbitrage rule regulations. **Treasury officials acknowledged that the proposed issue price rules could be problematic for competitive bond deals but did not foresee significant problems for negotiated transactions.** Several witnesses from industry groups testified and most said the proposal would be detrimental to the municipal market. A major concern is the change in the determination of the issue price of the bonds from the current 10% reasonable expectations test (the price the underwriter expects to sell 10% of the bonds at the time of sale), to a new 25% expectations test of the actual bond sales to customers outside of the underwriting team. Witnesses noted that it may be difficult to have 25% of each maturity sold at the time of the sale, which could lead to other problems, such as underwriters pricing deals at higher rates to be able to market the bonds and meet that threshold. They noted that competitive sales are at a worse disadvantage under the proposal because the bonds cannot be presold. Other problems could arise, including that the tax certificate may not be able to be done at the time of sale, nor could an issuer develop vital investment strategies and arbitrage compliance tables without the issue price being determined with certainty on that day. A larger issue also looms, which is if 25% of sales do not occur at the day of the sale, would the issuer have to monitor sales and trading to know when the thresholds have been met? Market participants noted that there is no system that exists that has this information available. IRS and Treasury officials did not appear convinced of the problems raised by the witnesses, stating that they have been told that a review of current practices indicates that the threshold for actual sales could be met.

WHAT THIS MEANS FOR YOU: It is unlikely that these proposed regulations will be finalized in the near future. This will allow time for industry participants to continue to push for less drastic changes. However, issuers should be aware that if the proposal becomes finalized as written, their administrative responsibilities will likely increase as well as their debt issuance costs, as discussed in the 9/23 [MIB](#).

PENSIONS, REGULATORS AND SLGS SUSPENSION

MOODY'S: LOCAL PENSION COSTS REMAIN ELEVATED IN 2014: Moody's Investors Service released another [report](#) on pension costs, noting that they will weigh on local government budgets in 2014, despite some reductions in liabilities. The report said rising interest rates and strong investment performance lowered liabilities going into 2014, but costs remain higher. Moody's expects improvements in its Adjusted Net Pension Liabilities (ANPLs) as FY 2013 actuarial valuations are released throughout the year. But, continued high pension costs will persist and put budgetary pressure on local governments. Moody's noted multiple years of positive actuarial experience will be necessary to reverse the elevated liabilities and costs trend. Moody's expects more clarity to come out this year on certain legal issues, noting there are "likely to be rulings and reform measures that could set precedent on whether benefits can be curtailed for future work by current employees, protections of cost of living adjustments, and whether pensions are viewed as contracts that can be impaired in Chapter 9 proceedings."

SEC'S WHITE: MORE RESOURCES NEEDED FOR MUNICIPALS: The Securities and Exchange Commission's Chairman Mary Jo White highlighted the Municipal Securities division's work on implementing the final Municipal Advisor (MA) rule, but the SEC needs more resources in municipal and other divisions to meet its responsibilities from the Dodd-Frank Act. White [testified](#) before the Senate Banking Committee to update Congress on its progress in meeting Dodd-Frank mandates. She said that the Municipal Securities Office is monitoring pension disclosure, accounting, and municipal bankruptcy issues and it will assist in considering further recommendations to the commission in re-

gard to disclosure, market structure, and price transparency in the municipal securities markets.

SLGS SUSPENDED: On Thursday, the U.S. Treasury announced it was suspending the issuance of state and local government securities (SLGS) beginning last Friday as part of its use of "extraordinary measures" to avoid hitting the debt ceiling. On Friday, Treasury Secretary Jack Lew [warned](#) Congress that the federal government will reach limit by Feb. 27 and urged them to raise the ceiling by that date. "Based on our best and most recent information ... we are not confident that the extraordinary measures will last beyond Thursday, Feb. 27," he wrote to congressional leaders.

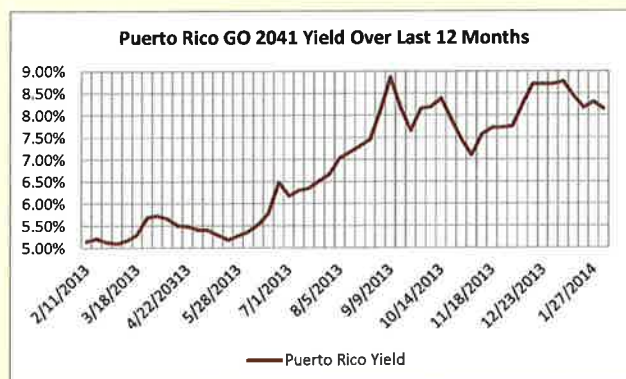


Figure 2: Yields on Puerto Rico bonds have risen nearly 400 basis points in the last 12 months as the island has been mired with economic decline and fiscal mismanagement.

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

NORTHEAST

On February 6th, **Citigroup Global Markets Inc.** priced \$136 million of general obligation bonds for the **County of Middlesex, New Jersey**; NR/AAA/NR; not callable :

Maturity	Coupon	Yield	+/- AAA 5%
2017	3.00	0.70	-24
2019	4.00	1.40	+35
2022	4.00	2.44	NA

Notes: Lower coupon were successful with shorter maturities.

MID-ATLANTIC

On February 4th, **PNC Capital Markets LLC.** priced \$5.9 million of general obligation bonds for **Abington Heights SC, Pennsylvania**; NR/AA/NR; not callable:

Maturity	Coupon	Yield	+/- AAA 5%
2015	1.00	0.30	+11
2017	3.00	0.75	+28
2018	4.00	1.10	+34

Notes: Shorter maturities targeted SMA interest.

MIDWEST

On February 6th, **Stifel Nicolaus & Co.** priced \$ 135 million of unlimited tax general obligation bonds for **Cleveland Heights City School District, Ohio**; Aa2/AA/NR; callable in 6/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2015	1.50	0.33	+14
2029	5.25	3.53	+22
2051	5.00	5.00	

Notes: A 5% coupon price to par in 37 years is a rarity.

SOUTHEAST

On February 5th, **Citigroup Global Markets Inc.** priced \$46 million of general obligation bonds for the **Cherokee County School System, Georgia**; Aa2/AA-/NR; callable in 8/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.38	+27
2024	5.00	2.83	+29
2029	5.00	3.40	+9

Notes: The state aid withholding boosted the bonds to Aa1/AA+.

SOUTHWEST

On February 4th, **Wells Fargo Securities** priced \$16 million of general obligation bonds for the **Arlington ISD, Texas**; Aa1/AA/NR; callable in 2/15/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.21	+10
2024	2.62	2.76	+11
2039	4.50	4.22	+19

Notes: PSF enhancement helped this issuer lower borrowing costs.

FARWEST

On February 6th, **RBC Capital Markets Inc.** priced \$47 million of general obligation bonds for the **Alaska Municipal Bond Bank**; Aa2/AA+/AA+; callable at par in 3/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	2.00	1.25	+29
2024	5.00	2.85	+35
2034	5.00	3.91	+10

Notes: Being a rare issuer with a higher bond bank rating helped.