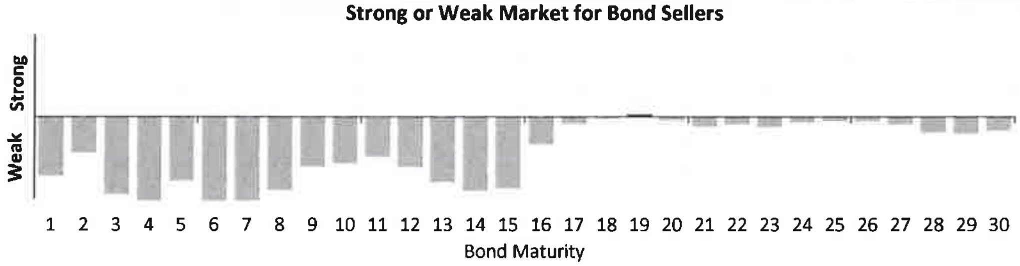
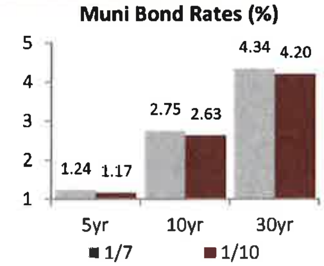
MMA The Power of Independence

JANUARY 13, 2014

MUNICIPAL ISSUER BRIEF





*Heading into this week, the weak dynamic that began last week as a result of a new calendar year is still in effect. Shorter maturities are particularly afflicted right now and it is here that **MMA** sees the chance of greater investor resistance in the near-term.*

MARKET UPDATE

MUNICIPALS STRONG ALL WEEK AND RALLY ON FRIDAY: The tone set for the start of this week is a strong one following a rally on Friday after economic data. New issuance is again below average tipping the supply/demand dynamic in favor of issuers.

INVESTORS & ISSUERS: Market starts out well for issuers this week.

- **All bond markets rallied on Friday after economic data on job creation missed forecasts.** Municipals participated in this rally but perhaps even more important, the general market did well the entire week while other bond markets faltered.
- **Last week, two high-grade issuers found extremely strong interest in their competitive sales.** Triple-A rated Princeton University and double-A plus state of Ohio were well bid on Wednesday. The strong turnout helped the entire municipal market improve when the Treasury market was weakening.
- **With the help of the deals mentioned above, longer-dated municipal bonds performed very well.**
- **New York state announced it would sell fewer bonds in the first quarter.** In the last six months the state has seen elevated issuance and yields have generally increased with the supply. This announcement led to improved trading for the state.
- **Investors pulled the least amount of cash out of municipal bond mutual funds in over 8 months.** This was a positive development for issuers, as, if the funds stop losing cash they will resume purchasing your deals in a more coherent manner.
- **California GOs continued to outperform the rest of the market.**

MUNICIPAL ADVISOR RULE: On Friday, the Securities and Exchange Commission (SEC) released a 19-page frequently asked questions on its new Municipal Advisor rule. Meanwhile, the Municipal Securities Rulemaking Board (MSRB) released its first round of proposed regulations related to the SEC's new rule. The MSRB rule proposals discuss conduct and responsibility standards for Municipal Advisors, and have numerous implications for issuers and how they interact with municipal advisors and other market professionals. Today the SEC delayed enforcement of this rule until July 1st, 2014.

BUYER BITES:

WHAT IS TRENDING HOT:
1) California GOs
2) New York
3) Bonds maturing 20-years and longer

CURRENTLY HARDER SELLS:
1) 4% coupons or lower outside of 20-years
2) Lack of liquidity on smaller, non-rated deals

WHO IS REPORTEDLY BUYING:
Retail in 10-years and longer, large banks and life insurance companies

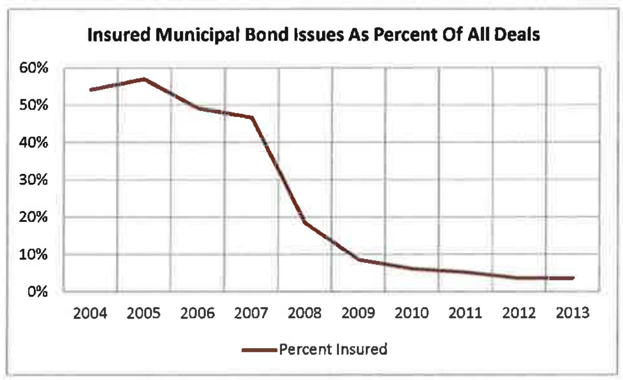


Figure 1: *Municipal bond insurance has fallen to ~3% of all new-issues over the last two years from the highs of over half all new deals coming with a bond insurance policy. Large downgrades in 2007 and 2008 left these companies marginalized. The prospects for municipal bond insurance are discussed in this week's **Topic of the Week** on page 3.*

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TOPIC OF THE WEEK: BOND INSURANCE OUTLOOK

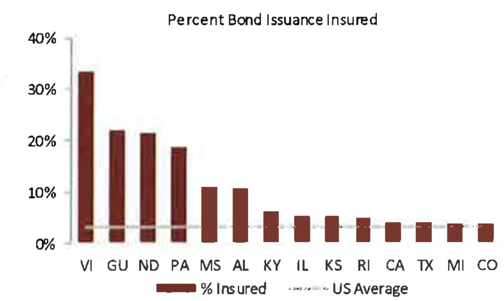
BOND INSURANCE: In 2014, bond insurers will be looking to build on the roughly 3% issuer penetration rate over the last two years. There are opportunities and challenges for this once massive industry.

Opportunities:

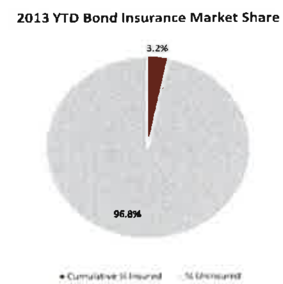
- Tax-exempt yields are at their highest in 2-years and could continue to rise, which in theory adds savings to the use of insurance.
- More new-money issuance is expected and less refundings (see last week's Market Outlook here) implies more insurance use.
- Recent unpredictable credit risks of late like the damage to the Michigan GO in light of Detroit (for more click here) or the impact of Federal court jurisdiction in Jefferson County make insurance more palatable for investors looking for extra protection.
- The re-rating of National Public Finance Guarantee to perhaps double-A minus by Standard & Poor's should spur investors and underwriters alike to promote the value of this new company.

Challenges:

- With mutual fund outflows eventually dissipating (see last week's Market Outlook for more) we expect lower-rated credits to improve, which is generally where the best savings come from with bond insurance.
- Some rating agencies are upgrading municipal credits at a very fast clip, again lessening the amount of lower-rated credits to be insured (read more on this trend here).
- The investor base of municipal bonds is changing. With more investors moving into managed investment vehicles (see here for more) and less buying directly, there will be less emphasis on purchasing a bond with an insurance policy on it.
- Bond insurance companies have sizeable exposure to Puerto Rico. While **MMA** views the insurers as able to manage hypothetical delayed payments in a restructuring of the island's debt, this is not a positive development for these firms.



Those with the highest percentage of insured debt in 2013 are US territories.



Only 3.2% of all new deals came insured in 2013.

WHAT IT MEANS FOR YOU: Looking beyond the simple cost/benefit analysis of purchasing an insurance policy can be important. The shift in how the market perceives insurance is key. In its heyday, insurance was generally viewed as security replacement with less emphasis on the issuer's actual credit. Since its demise, it is now viewed as security enhancement, meaning that the investor is comfortable with your credit and the insurance is an extra protection. For an issuer, this means, all else being equal, that you are not getting as much savings as you did when insurance was viewed as a replacement because investors have to do more credit work and pass those costs on to you. If insurance were to grow in use, it may increase the cost savings and make sense for more issuers. Additionally, if insurers are upgraded, issuers will have to file additional disclosure if they have outstanding insured bonds.

NEW DTC FEES BEGAN JANUARY 2

The Depository Trust Company (DTC) filed a notice with the SEC on December 30 that its municipal debt eligibility fee will increase. Most municipal issuers must pay a fee to DTC for their depository delivery and settlement services system, which serves as a clearinghouse for securities trading. The change in fees reflects DTC's costs associated with the differences between corporate and municipal securities, where corporate securities have one maturity associated with the bond deal, and most municipal securities have multiple maturities associated with the deal. Each maturity is assigned a CUSIP number (identifying number of the bond), and the DTC fees are based on whether an issue has a single or multiple CUSIPs associated with the transaction.

The fee changes are as follows – for municipal securities issues with one CUSIP, the fee remains at $350. For municipal securities issues with multiple CUSIPs, the fee increases to $800.

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

NORTHEAST

On January 9th, **Barclays Capital** priced $150 million of Northeastern University revenue bonds for the **Massachusetts Development Finance Authority**; A2/NR/NR; callable at par in 3/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2032	5.00	4.40	+57
2039	5.00	4.76	+43
2044	5.00	4.87	+54

Notes: The University was one of several higher-ed deals last week.

MID-ATLANTIC

On January 8th, **Janney Montgomery Scott** priced $9 million of general obligation bonds for **Northwestern Lehigh School District;** NR/AA/NR; callable in 2/15/2019:

Maturity	Coupon	Yield	+/- AAA 5%
2018	5.00	1.60	+37
2023	5.00	3.53	+78
2033	4.50	4.71	+69

Notes: A local underwriter helped with this small school district.

MIDWEST

On January 9th, **JPMorgan Securities LLC** priced $64 million of unlimited tax general obligation bonds for **the Livonia Public Schools District, Wayne County, MI**; NR/A/NR; callable at par in 5/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2015	2.00	0.59	+38
2019	5.00	2.26	+102
2024	4.00	4.09	+135

Notes: BAM insurance was applied to enhance the single-A rating.

SOUTHEAST

On January 9th, **Charleston South Carolina** sold $22 million of unlimited tax GO bonds to **Robert W. Baird & Co. Inc.**; Aa1/AAA/NR; callable in 3/1/2022:

Maturity	Coupon	Yield	+/- AAA 5%
2019	2.00	1.26	+2
2024	3.00	2.78	+4
2029	3.50	3.66	+15

Notes: A lower coupon structure was used by Baird to win the deal.

SOUTHWEST

On January 9th, **Hutchinson, Shockey, Erley & Co.** priced $38 million of sales tax revenue refunding bonds for **Corpus Christi Business and Job Development Corporation**; A1/A+/AA-; callable in 9/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2014	2.00	0.30	
2019	5.00	2.00	+76
2024	5.00	3.70	+96

Notes: Investor reception was very positive leading to lower yields.

NORTHWEST

On January 9th, the **San Francisco Unified School District** sold $205 million of general obligation bonds to **JPMorgan Securities LLC**; Aa2/AA-/NR; callable at par in 6/15/2022:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	0.33	-2
2024	5.00	2.86	+12
2029	4.00	3.90	+39

Notes: Lower coupons out long did not trade well in the secondary.