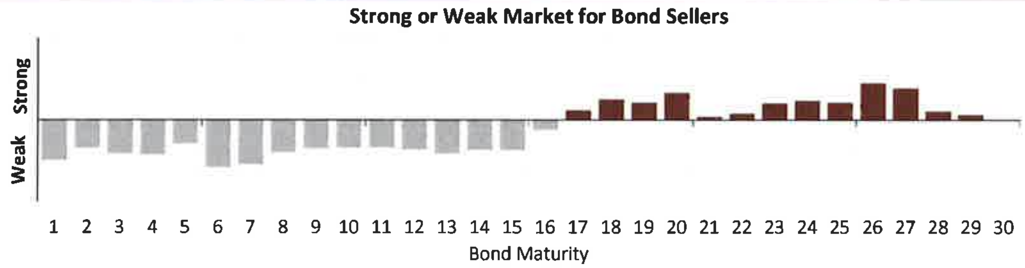
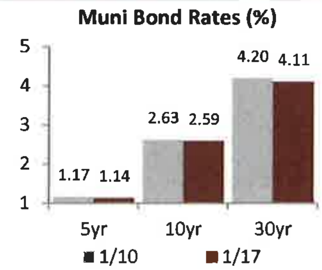
MMA The Power of Independence

JANUARY 21, 2014

MUNICIPAL ISSUER BRIEF





Heading into this week, issuers of bonds 16-years and longer should benefit from stronger price execution—in line with commentary below regarding interest in longer-dated municipal bonds. The context for shorter maturing securities is clearly weaker.

MARKET UPDATE

MUNICIPALS CONTINUE TO MOVE TO LOWER INTEREST RATES: The market for municipal bonds improved all week despite weakness in other bond markets mid-week. This outperformance is occurring as underlying influences continue to support lower rates.

INVESTORS & ISSUERS: The strong market for issuers continues.

- **Municipal bonds improved throughout the week despite headwinds at times.** January issuance has been less than market expectations, despite being consistent with historical patterns. As a result, the demand/supply imbalance favors municipal issuers. Municipal investors are benefitting as well as yields have fallen.
- **Longer-maturing bonds improved the most** as insurance companies and non-traditional investors were buying municipal yields that were higher than taxable levels. Issuers of longer-dated bonds can benefit from this institutional interest.
- **Competitive deals were very well received last week and we expect the same this week.** Early on, underwriters were aggressive on last week's competitive deals and this helped strengthen the tone for the entire market.
- **This week the state of Washington sells** nearly $700 million GOs on Wednesday. Interestingly, last January, the state had a similar set of sales that eventually ended up starting a swift sell-off to higher rates as dealers that bought the bonds could not find end buyers of the GOs. Monitor this sale.
- **California rallied on rating action.** Standard & Poor's put the state on positive outlook last week and this helped California's outstanding debt but also helped other California issuers.
- **High yield on a streak.** As noted in **Buyer Bites**, healthcare and senior living bonds have improved, but in general, lower-rated bonds have rallied even more than higher-rated municipals.

MUTUAL FUND HIGHLIGHT: As noted in our market outlook 2 weeks ago, the mutual fund complex has been a major headwind to a successfully functioning market as investors pulled out their investments in 2013. Last week it was reported that the funds that buy your municipal bonds saw investors put cash into their funds for the first time since May 2013. This is a positive development but **MMA** is not convinced this is a long-term shift just yet. One item to consider is that much of the investments into funds were into exchange-traded funds (ETFs) that are more "fast money" than a consistent presence. RBC's **Chris Mauro** analyzed last week's data here.

BUYER BITES:

WHAT IS TRENDING HOT:
1) California GOs
2) Healthcare & Senior Living
3) Bonds maturing 20-years and longer

CURRENTLY HARDER SELLS:
1) 4% coupons or lower outside of 20-years

WHO IS REPORTEDLY BUYING:
Mutual funds, life insurance companies, pension funds, individuals in the 10 to 15 year range

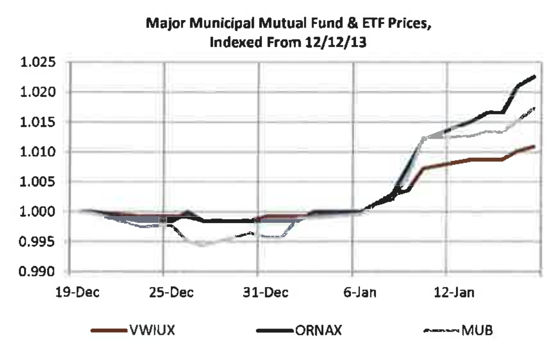


Figure 1: *Above the performance of 3 major funds that invest in municipal bonds is tracked since mid-December. The combination of letters is each funds equity 'ticker.' ORNAX invests in lower-rated municipal bonds while VWIUX and MUB are more high-grade oriented. The very strong performance since the start of the year correlates with issuer borrowing costs decreasing and is likely helping to stem these funds from losing cash (see MUTUAL FUND HIGHLIGHT to the left). Also note that the fund that invests in lower-rated bonds is the best performer, in line with commentary in above. Lower-rated issuers potentially benefit from this.*

TOPIC OF THE WEEK: MA RULE UPDATES

MUNICIPAL ADVISOR RULE: On January 13, the Securities and Exchange Commission (SEC) extended the effective date for its new Municipal Advisor (MA) rule to July 1 to give underwriters, municipal advisors, and other professionals more time to develop internal compliance procedures. The SEC released a Frequently Asked Questions document about the MA Rule, addressing many issues related to how to define "advice" and the types of communication underwriters can and cannot have with issuers. Among the highlights:

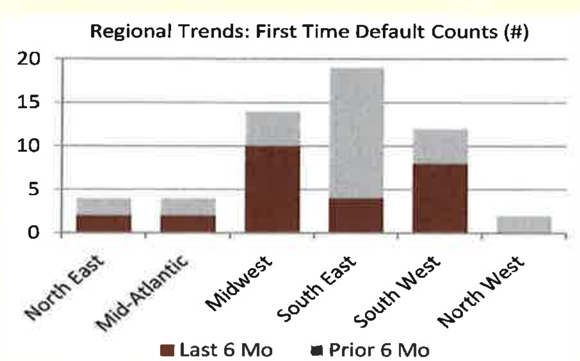
- Underwriter RFPs. Underwriters may include recommendations and advice when responding to an issuer's RFP if: the RFP is about a specific financing, the RFP has been sent to at least 3 reasonably competitive firms or is posted on the issuer's website, and has a response timeframe of less than 6 months. ***Issuers should review their RFP policies to ensure that they mirror the parameters set forth by the SEC.***
- Engaging Underwriters. Once an issuer engages an underwriter for a specific transaction, the underwriter qualifies for the underwriter exemption. ***Issuers may wish to establish internal procedures allowing them to sign a letter of engagement with the underwriter early in the process of the transaction. This will make for an easier line of communication.***
- Utilizing the Municipal Advisor Exemption. When an issuer has a municipal advisor as part of its financing team for a specific transaction, an underwriter and other professionals may provide advice to the issuer if they have representation from the issuer that a municipal advisor is advising the issuer. An issuer may post this declaration on their website to ensure wide distribution. ***Issuers should consider developing a statement regarding their use of a municipal advisor and post it on their website.***
- Issuer/Underwriter Communication. Unless the underwriter falls within an established exemption in the rule, they may not provide advice to the issuer, even if the issuer calls the underwriter directly. ***Issuers should be aware of limitations that underwriters will have in their communications with them, unless an exemption is met.***

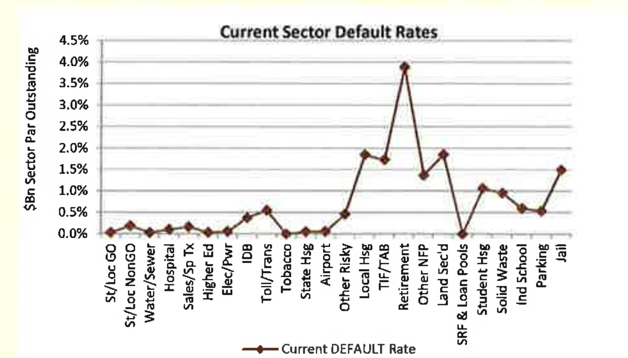
MSRB Proposed Rulemaking Related to Municipal Advisors. As a follow-up to the SEC's MA Rule, the MSRB proposed rulemaking for financial advisors. The MSRB is accepting comments until March 10, and following review of comments will propose rulemaking changes to the SEC (which will also be available for public comment). Key items for issuers include:

- Conflicts of Interest. The proposed rule would prohibit a MA from providing services to an issuer if its firm or its affiliates provide any other types of principal services to the government. ***This section of the proposed rule could significantly affect issuers by not allowing them to use broker/dealer municipal advisors, nor allowing the same financial institution to be both a financial advisor and provide brokerage services.***
- Suitability Standard. A MA may not make a recommendation to an issuer unless it meets certain standards that the transaction is suitable for that particular government. ***Smaller governments especially may be affected from this proposed rulemaking, as more sophisticated products meant for large and frequent issuers would not be suggested.***
- Brokers and Bond Proceeds. Brokers may not advise issuers on how to invest bond proceeds, and then be the institution that provides those investments. ***Governments may wish to review their investment of bond proceed procedures and make adjustments if needed to ensure that their broker and investment institution are not affiliated.***

DEFAULT TRENDS

In 2013 the number of rated municipal bonds in payment default was 30; a very low figure. While payment default is not a topic that many state and local issuers encounter, it is a topic that all issuers should monitor as investors may penalize an issuer for being geographically close to a defaulted entity or associated similar revenue streams. The charts below look at what regions are seeing more default activity (**left**) and then for what types of projects (**right**). If you are in one of these regions or issue a similar type of bond (retirement or jail for example) you should be especially aware of these trends as it may affect your borrowing rates.





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

NORTHEAST

On January 16th, **JPMorgan Securities LLC** priced $855 million future tax secured subordinate revenue bonds for the **New York City Transitional Finance Authority**; Aa1/AAA/AAA; callable at par in 5/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.61	+46
2024	5.00	3.10	+50
2029	5.00	3.63	+27

Notes: The state announced it would be selling fewer bonds in Q1.

MID-ATLANTIC

On January 14th, **Ramirez & Co., Inc.** priced $122 million of water and wastewater revenue refunding bonds for **Philadelphia, Pennsylvania;** A1/A/A+; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.59	+44
2024	5.00	3.25	+64
2043	5.00	4.70	+53

Notes: The 5% coupon structure targeted institutional investors.

MIDWEST

On January 15th, **Hutchinson Shockey Erley** priced $7 million of general obligation bonds for **Cook County, Illinois SD #124**; A1/NR/NR; Build America Mutual insurance applied; not callable:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.82	+65
2022	4.00	3.05	+82
2024	4.00	3.35	+72

Notes: BAM insurance was especially effective with Illinois issuers.

SOUTHEAST

On January 16th, **Wells Fargo Securities** priced $19.5 million of general obligation bonds for **Greensboro, North Carolina**; Aaa/AAA/AAA; callable in 2/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.19	+4
2024	3.00	2.72	+12
2029	5.00	3.34	-3

Notes: The issuer benefitted from a locally based underwriter.

SOUTHWEST

On January 14th, **Morgan Stanley & Co.** bought $25 million of street and highway revenue bonds from **Pima County, Arizona**; NR/AA/AA; callable in 7/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.50	+35
2024	3.00	3.00	+40
2028	3.375	3.46	+21

Notes: The par-coupon structure attracted retail investors.

WEST & NORTHWEST

On January 15th, **Piper Jaffray** priced $65 million of special tax revenue refunding bonds for the **South Orange County Public Financing Authority LLC, CA**; NR/BBB+/NR; callable at par in 8/15/2021:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.89	+72
2024	5.00	3.58	+95
2029	5.00	4.26	+86

Notes: Privately managed account interest lowered borrowing costs