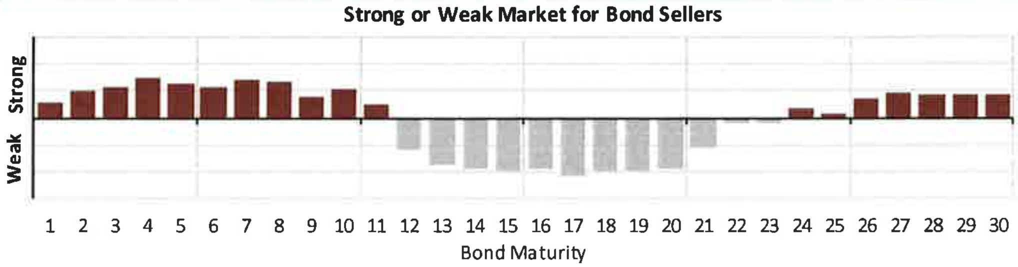
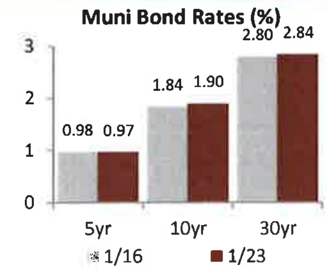
# MUNICIPAL ISSUER BRIEF




*Heading into this week, the intermediate part of the yield curve—11 to 21 years—continues to offer a problematic dynamic for issuers after the last 3 weeks of strong performance. For those issuing in the shorter part of the curve the market environment suggests a favorable pricing context, according to our indicators.*

## MARKET UPDATE

**VOLATILITY IN THE MARKETS:** Municipal bonds' yields were held hostage to the U.S. Treasury bond market's volatility, but a strong showing Friday encouraged a favorable condition for issuers looking to access capital markets in the near-term.

**INVESTORS & ISSUERS**: The market was not kind to issuers last week

- A volatile week in Treasury markets led to tax-exempt bond yields rising.
- The European Central Bank announced a plan to buy European debt to encourage economic growth, which sparked a back-and-forth in rate direction that ended the week at higher yields.
- In the municipal space, the holiday-shortened week had a large new-issue slate, which struggled amid the volatility.
- The state of Washington sold more than $900 million of general obligation bonds at yields that were cheaper than recent markets. Watching higher-grade issuers in the competitive markets can signal how the broader market is faring—and last week the state suffered along with the rest of the market.
- Still—lower than 2% yields in 10-years, on two of the three series offered, represented historically low borrowing costs. (See page 3 for more on regional deals.)
- Healthcare issuers that have done well of late, suffered last week as a few large institutional sellers made it difficult to sell bonds in the primary.
- This week's new-issue calendar is smaller than last week, and the inclement weather in the Northeast is already forcing some issuers to postpone deals, such as $1 billion Pennsylvania GO issue that was scheduled to sell on Tuesday.
- Large domestic banks continued to buy longer-dated maturities. Their presence has provided a supportive bid to the long end.

**OBAMA TO PUSH BANK-QUALIFIED LIMIT IN BUDGET:** Last week, *The Bond Buyer* reported that the Obama Administration will include a proposal to permanently increase the small issuer bank-qualified limit to $30 million from $10 million and modify the 2% de minimis rule to include banks. These two proposals were part of the American Recovery and Reinvestment Act (ARRA) that was in effect in 2009-2010. The budget will also include Obama's Qualified Public Infrastructure Bond (QPIBs) program that he unveiled this year. With a Republican-controlled Congress, it will be difficult to sell ARRA-related proposals, as Republicans have been near universally opposed to them. For more on DC, see last week's MIB.

### BUYERS BITES:

**WHAT IS TRENDING HOT:**

**1) New Jersey GO and appropriation-backed**
**2) Texas paper**
**3) Bonds maturing 20-years or longer**

**CURRENTLY HARDER SELLS:**

**1) The intermediate portion of the curve**
**2) Washington GO**

**WHO IS REPORTEDLY BUYING:**

**Large domestic banks, mutual funds, SMAs**

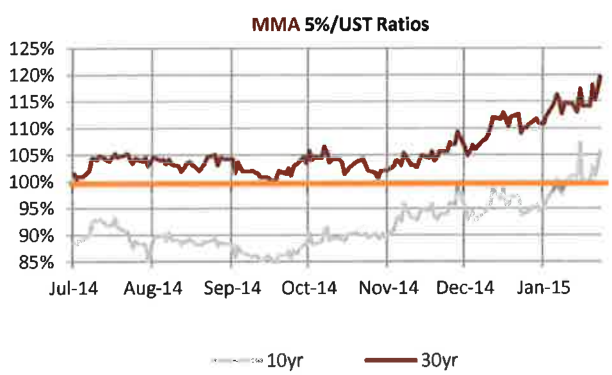



***Figure 1**: Tracking the relationship between tax-exempt municipal bond yields and those of the U.S. Treasury bond market can be instructive in understanding buyers' investment strategy. The chart above tracks the triple-A municipal bond yield divided by the Treasury bond yield. Note that the percentage—or ratio– has moved well above 100% for both the 10-year and 30-year maturities.* ***This means that exempt bonds yield more than taxable bonds—and indicates that buyers are likely seeing more value in municipal bonds, especially alternative accounts.***

**MMA** Independent & Data Driven

## TOPIC OF THE WEEK

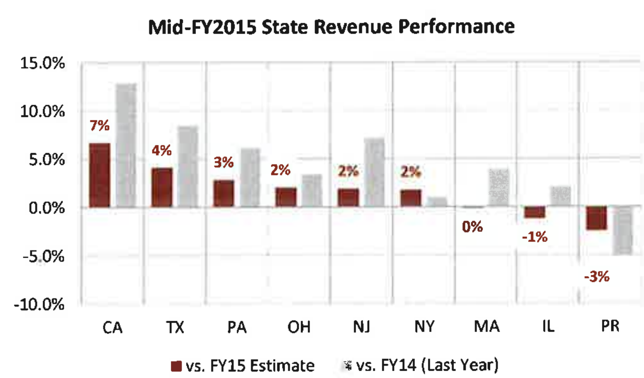
**RATINGS TRENDS**: All three major ratings agencies have a stable outlook for both state and local governments in 2015. Consistent with its recent rating trends, Standard & Poor's has struck a generally positive tone regarding its outlook for states and local governments in 2015. **MMA** agrees with the mixed assessment for the state sector. States with large legacy liabilities—particularly those with lagging economic and population growth (e.g. IL, NJ, PA)—are likely to see their credit position weaken this year while other states maintain or improve credit quality. (See more **below**.) Additionally, **MMA** thinks it is likely that most local governments will successfully navigate the challenges of slower growth and rising employee-related costs while maintaining—or modestly impacting—credit quality. The rating agency notes that most local governments weathered the recession as expected, demonstrating sector resilience. Post-recession—and following implementation of its new criteria—nearly 70% of local government ratings are in the AAA or AA category and only 3% of ratings are in the BBB category or lower.

*What it means for you:* With all three agencies seeing a stable outlook, rating trends in 2015 should be more on the positive side. A subtle, often overlooked ratings distinction is that S&P's and Fitch's ratings measure default probability while Moody's ratings take into account both default probability and loss given default. This implies more rapid and pronounced rating transitions for S&P and Fitch ratings when default probability is no longer theoretical. Generally speaking, the spread between ratings should be greatest in situations in which there is a high probability of default and a very low or no expected loss given default.

**Speaking of defaults**, risky sector municipal default rates inched higher between last summer and January 2 (average increase was 0.3%), while safe sector default rates fell, on average, by 0.4%. **MMA** expects the number of issuers defaulting for the first time to continue to remain small, consistent with the slowing pace of first-time defaulters in the last few years. The fastest-rising risky sector default rate has been solid waste projects, up by 0.19% to 1.17%. The highest overall default rate has remained retirement homes, with 5.049% of outstanding bonds now involved in an uncured payment default (which is up by 0.173% from the last update). Other notable risky sector rates are land-secured (up by 0.112% to a rate of 1.856%), local multi-family housing (down by 0.067% to a rate of 1.469%), IDBs (down sharply by 0.259% to a rate of 0.143%), and charter schools (newly calculated: 1.419%).

*What it means for you:* Safe sector issuers have reflected improved conditions as the broader economy has recovered. There were only 3 safe sector defaulters in 2014, two of which were Detroit-related, which means number of defaulted safe sector credits is falling faster than the outstanding municipal market is contracting. Notable safe sector default rates: state and local GOs (down to a remarkably low 0.004% from 0.030%); state and local appropriation credits (down to 0.153% from 0.232%); water and sewer credits (steady at 0.035%); and toll roads (up fractionally to 0.518% from 0.515%). Issuers should continue to emphasize to their investors this positive trend, and note that most defaulted issuers have occurred in the sectors of greatest risk.

**State revenues climb**, and a look at state revenue data is favorable for state rating trends and, by extension, generally constructive for credit quality in state-aid dependent local entities. Midway through fiscal year 2015, states are exceeding budgeted projections by 1.5%; and are 5.3% above last year's levels. Sales tax collections are flat versus forecast; income tax collections up 2%. (**Figure 2, right**)




Still, wide variation is evident and issuers in certain states should take note of trends:

- California is a standout, exceeding forecasts by 6.7% lead by personal income tax, which is outperforming forecast by 7.1%.
- New Jersey and Illinois both also continue to lag forecasts: Of the 14 major revenues tracked each month in New Jersey, only the income tax is growing at a rate above the certified year-end target growth rate. In Illinois, the new governor recently addressed the state's "dire fiscal condition" characterized by a mid-year budget hole totaling nearly $1.5 billion as the onset of 2015 brought an income tax rate decrease from 5% to 3.75%. The corporate tax also declined from 7% to 5.25%.
- Meanwhile, energy-producing states, such as Texas, Arkansas, and North Dakota, are feeling the impact of low oil prices on revenues and budgets. Personal income tax collections have dropped too as declining energy prices hurts royalties paid to owners of natural gas-producing properties. Still, it is too early to expect negative rating actions will result, noting in particular how sales taxes have offset some of the losses elsewhere.
- Puerto Rico, which released December revenues in early January, is now lagging estimates by 2.5% (or $96.5 million) and last year by 5.1%. Note that corporate taxes are 22% of PR's total revenue take, well above the 7% state average.

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

### NORTHEAST

1/21: **JPMorgan Securities LLC** priced $265M Partners HealthCare System revenue bonds for the **Massachusetts Development Finance Agency**; Aa3/AA/AA; callable at par in 7/1/2025:

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2020 | 5.00 | 1.30 | +35 |
| 2025 | 5.00 | 2.21 | +37 |
| 2045 | 5.00 | 3.04 | +23 |

**Notes: This deal priced on a heavy new-issue day, faced challenges**

### MID-ATLANTIC

1/19: **RBC Capital Markets** priced $9.7M limited general obligation bonds for **Mifflin County, School District, Pennsylvania**; NR/A/NR; callable at par in 3/1/2020:

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2015 | 0.25 | 0.25 | N/A |
| 2025 | 2.25 | 2.375 | +54 |
| 2028 | 3.25 | 2.60 | +49 |

**Notes: Bank-qualified and BAM insurance lowered costs**

### MIDWEST

1/21: **Bank of America Merrill Lynch** priced $232M general obligation bonds for the **Nebraska Public Power District**; A1/A/A; callable in 1/1/2025:

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2020 | 5.00 | 1.23 | +28 |
| 2025 | 5.00 | 2.09 | +25 |
| 2035 | 5.00 | 2.78 | +20 |

**Notes: The issuer fared well on a tough market day**

### SOUTHEAST

1/21: **Pidgeon Forge, Tennessee** sold $9.9M general obligation bonds to **FTN Financial Capital Markets**; NR/AA/NR; callable at par in 6/1/2021:

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2016 | 2.00 | 0.40 | +21 |
| 2025 | 2.00 | 1.90 | +6 |
| 2037 | 3.00 | 3.125 | +48 |

**Notes: Spreads on the 10-year were good for the rating**

### SOUTHWEST

1/19: **Stifel Nicolaus & Co.** priced $55.6M transportation revenue bonds for **Glendale, Arizona**; A3/NR/NR; AGM (A2/AA/NR); callable at par in 7/1/2025:

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2021 | 5.00 | 1.61 | +38 |
| 2025 | 5.00 | 2.36 | +52 |
| 2031 | 3.00 | 3.25 | +92 |

**Notes: Assured insurance benefited the issuer**

### FARWEST

1/22: **JPMorgan Securities LLC** priced $204M Queen's Health Systems special purpose revenue bonds for the **Department of Budget and Finance for the State of Hawaii**; A1/AA-/NR; callable in 7/1/2025:

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2020 | 5.00 | 1.48 | +52 |
| 2025 | 5.00 | 2.44 | +55 |
| 2035 | 5.00 | 3.09 | +47 |

**Notes: This issuer re-priced with yields 25 basis points cheaper**