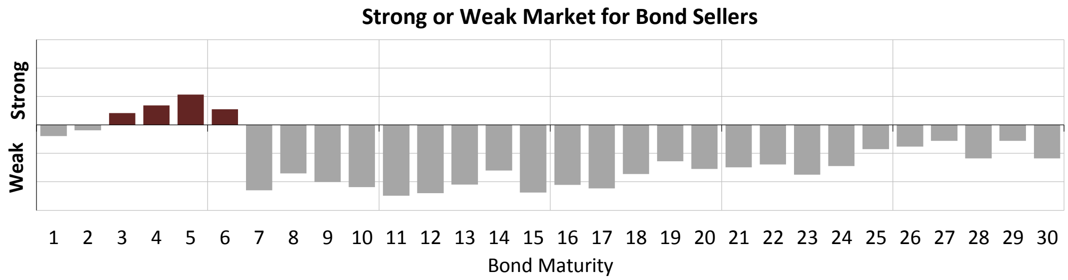
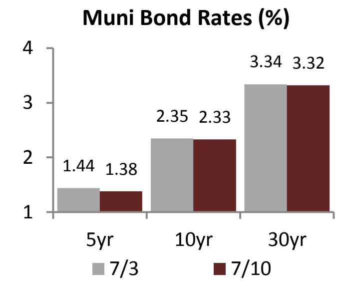
MMA Independent & Data Driven

JULY 13, 2015

MUNICIPAL ISSUER BRIEF





Heading into this week, a decidedly negative pricing dynamic has come into play for most maturities after the Treasury market lost as much as 20 basis points on Thursday and Friday.

MARKET UPDATE

NEAR-TERM ISSUERS FACE CERTAIN ADVERSITY: Borrowing costs began to move into higher ranges in the latter half of last week under the pressure of a declining Treasury market setting up a potentially challenging market in the near-term.

INVESTORS & ISSUERS: Higher rates and increased supply recently:

- As expected, Greece's fortunes **continue to move global interest rates** and in the latter half of the week it appeared more likely that Greece would not be leaving the European Union.
- This made for a much cheaper Treasury market as the so-called "safety-bid" began to make its way out of that market and this **created negative pressure for municipal bond borrowers**.
- Most issuers had already tapped the market by the time it negatively pressured tax-exempt rates **but secondary trading on Thursday and Friday to higher yields should change price expectations for issuers this week**.
- Adding some pressure is **nearly $9 billion of municipal bonds** scheduled to price (compare this to the roughly $4.5 billion over the last two weeks) that will put the supply/demand balance out of issuer's favor.
- Another area to monitor is municipal bond mutual funds, which have seen nearly 3 straight months of investors exiting those investments. For now **the market has done quite well managing the loss of those investors** but if it continues it may increase borrowing costs.
- Chicago will sell $1 billion of GOs this week. The deal will likely draw significant media attention, given the recent downgrades and well-publicized fiscal challenges. The eventual interest rates will be intriguing—and should help provide some lessons for other lower-rated issuers, but also other entities that are facing pension hurdles in the near-term (**read: NJ, PA and CT among others).**

BUYERS BITES:

WHAT IS TRENDING HOT:
1) Illinois Tollway revenue bonds
2) Large, frequent California issuers outperform
3) New York MTA

CURRENTLY HARDER SELLS:
1) Intermediate maturities (11-20yrs)

WHO IS REPORTEDLY BUYING:
Large and regional banks, life insurance companies, UITs

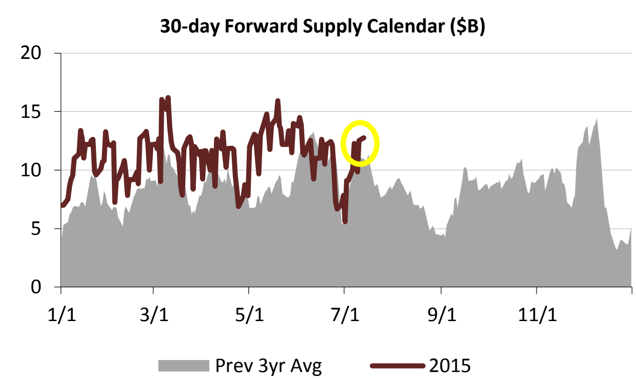


***Figure 1**: One way to track week-to-week issuance and projections over the next month is tracking the Bond Buyer's 30-day visible supply. In the chart above we track the tally going into this week (about $12.7 billion) compared to the average over the last three years on the same date represented above in the grey shaded area. Note today's supply total is about $3 billion over the seasonal average and may tip the supply/demand balance out of favor from issuers*

DC UPDATE: Last week Senator Ron Wyden (D-OR), the ranking minority member of the Senate Finance Committee, and Senator John Hoeven (R-ND) spoke at a recent Bipartisan Policy Institute's Executive Council on Infrastructure event on ways to address the country's infrastructure deficit. While the Senators and others focused comments on the need to invite private sector participation in public infrastructure spending, Senator Wyden did note the important role tax-exempt bonds have played and needs to play in building infrastructure for communities across the country. Read more here. For more on D.C., head to **page 2.**

TOPIC OF THE WEEK: PRICE GUIDANCE

PRICING BONDS: Last month the Internal Revenue Service re-proposed a set of rules that would dictate how prices for municipal bond deals are finalized that largely keeps the current method intact. This is the latest step in an ongoing process that, barring any major new suggestions, should come to an end later this year or in the first half of 2016. Initially, the IRS proposed several higher standards for how underwriters would determine a final price for a bond – most importantly raising the bar to 25% of each maturity sold to customers and taking out the "reasonable expectation" clause for price (you can read more about the initial proposals in our September 2013 MIB by clicking here). **MMA** viewed these changes as being overly cumbersome for underwriters that would have likely increased the cost of issuance for issuers. Some **MMA** takeaways from the re-proposed rules: 1) Allow for 10% of each maturity sold to customers to be sufficient; 2) If that 10% quota is not met, underwriters can then use an index of broad-based but similar municipal securities to justify any further price changes; 3) Narrow the definition of what is an underwriter; and 4) Do not take into account differences between a negotiated and a competitive issuance. The IRS is now in a period of accepting another round of comments before it makes a final judgement.

WHAT THIS MEANS FOR YOU: This is generally a positive development for issuers. The re-proposed rules largely followed what state and local bodies lobbied for as well as the dealer community. By keeping a lower threshold to close out a deal and giving underwriters flexibility, this will allow them to be more aggressive when finalizing prices with investors. This will become more important if the market does enter a period of rising interest rates based on Federal Reserve actions. There are two items though that **MMA** and many others in the industry believe merit further discussion before the rule is officially set. **First**, the proposed regulations do not provide an exemption or any special rules for competitive deals. In the cases where an issuer puts the bonds out for bid, market forces determine the issue price, which some believe should be taken directly as the issue price. Without a special provision or nod to competitive sales in the regulation, some issuers may struggle with meeting the requirements for determining issue price as proposed, an item that will likely be brought up by groups during this round of comments, as was done the last time the issue price regulations were proposed. **Second**, the process of how to finalize a price if the 10% threshold is not met is not entirely clear. Using an index to decipher change is good but there are many facets to a deal that are unique to that particular deal that an index may not take into account. **MMA** views the process of using an index to decipher market change as a positive although there may need to be additional language to broaden how a price can change.

Another aspect of this to consider is that the IRS mandating that an index of similar bonds be used as the method to determine price change is not how most bond deals are priced. As such, the IRS may be inadvertently setting higher standards for how municipal bond dealers determine pricing to begin with. This could have ramifications in the future and deserves a broader discussion of how municipal bond deals are priced—we discuss this topic further in the August edition of **GFOA**'s Government Finance Review.

WASHINGTON, D. C.

SENATE FINANCE COMMITTEE REPORTS: The much-anticipated reports from the Senate Finance Committee's working groups on tax reform were released last week, and the tax-exempt bond community gave a guarded sigh of relief, as no proposals to eliminate or alter TEBs were found in the documents. While certainly this is a better outcome than if the working group did suggest tinkering with this section of the tax code, the community must still be vigilant against any specific proposals that could be introduced that would reduce or eliminate the tax exemption.

MAYORS SUPPORT FOR TEB: At their annual meeting last month, the U.S. Conference of Mayors (USCM) adopted a resolution *Defending the Tax Exemption on Municipal Bonds*. USCM has been a strong supporter of bonds through the years and their resolutions reiterates that support by opposing "any proposal to cap, limit, eliminate or replace tax-exempt bonds." The group also supports the creation of new qualified tax-credit bonds for transportation that would stimulate infrastructure investment.

TREASURY P3 REPORT: In April, the U.S. Department of the Treasury released a report, *Expanding The Market For Infrastructure Public-Private Partnerships: Alternative Risk And Profit Sharing Approaches To Align Sponsor And Investor Interests*. The report provides an academic-like exploration of the use of Public Private Partnerships to help with the nation's transportation and other infrastructure financing needs, and the various incentive structures that could be used in the future. The paper does not dwell, nor barely mentions, the conventional and most often used means to pay for infrastructure—issuing tax-exempt bonds, and notes that "The challenge is for P3s to demonstrate overall cost savings and efficiencies that outweigh the lower-cost financing advantage of traditional procurement."

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

Three large deals that impacted the market last week and why (highlighted below):

- The **Illinois State Toll Highway Authority** was able to lower yields as much as 6 basis points and saw large oversubscriptions in the face of broader market declines on Thursday. This credit suffered no knock-on effect in the face of Chicago/Illinois issues.
- **Hillsborough County, Florida** timed the market perfectly last week selling competitively on Wednesday just before Treasuries began to slide to cheaper yields that afternoon and throughout the balance of the week. The results were good for the County, achieving a true interest cost of 2.189%. There were 9 bidders on the deal, which is an above average amount and indicative of broader support for the issue and the market at that time.
- **Austin, Texas** was also able to take advantage of the market conditions on Wednesday and was able to re-price its issue as much as 5 basis points lower and closed the account before the market declined the following day.

NORTHEAST

7/6: **Roosevelt & Cross Inc.** priced $6.1 million general obligation bonds for **Lewiston, NY**; A1/AA/NR (BAM); callable at par in 6/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	2.00	1.60	+22
2025	2.75	2.50	+23
2033	4.00	3.60	+65

Notes: Local underwriter helped place bonds locally

MID-ATLANTIC

7/8: **Suffolk, VA** sold $41.2 million general obligation bonds to **Fidelity Capital Markets**; Aa1/AAA/AAA; callable at par in 2/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	3.25	1.23	-15
2025	5.00	2.21	-6
2035	3.50	3.58	+54

Notes: Through the AAA Benchmark in 10yrs is aggressive for issuer

MIDWEST

7/9: **Bank of America Merrill Lynch** priced $400 million toll highway senior revenue bonds for the **Illinois State Toll Highway Authority**; Aa3/AA-/AA-; callable at par in 7/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2027	5.00	3.02	+53
2030	5.00	3.42	+66
2040	5.00	3.85	+68

Notes: Strong levels for Aa3-rated revenue in Illinois.

SOUTHEAST

7/8: **Hillsborough County, FL** sold $140 million community investment tax refunding revenue bonds to **JPMorgan Securities LLC**; A1/AA/AA; non-callable:

Maturity	Coupon	Yield	+/- AAA 5%
2016	3.00	0.48	+19
2020	5.00	1.61	+23
2025	5.00	2.60	+33

Notes: This saw tight bidding across the board.

SOUTHWEST

7/8: **JPMorgan Securities LLC** priced $244 million water and wastewater system revenue refunding bonds for **Austin, TX**; Aa2/AA/AA-; callable at par in 11/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.60	+22
2025	5.00	2.60	+33
2035	5.00	3.31	+27

Notes: Given no state tax the bonds price slightly cheaper

FARWEST

7/8: **Des Moines, IA** sold $19.6 million general obligation bonds to **Janney Montgomery Scott**; Aa2/AA+/NR; callable at par in 6/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.41	+3
2025	4.00	2.39	+12
2028	3.00	3.00	+38

Notes: Varying coupon structures out long likely from insurance cos