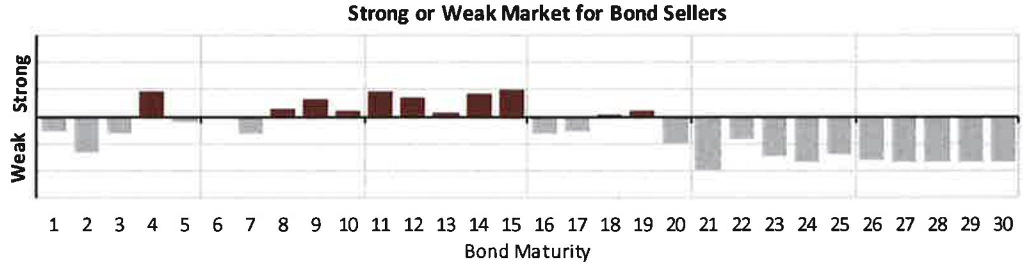
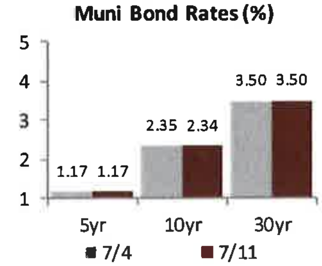
MMA The Power of Independence

JULY 14, 2014

MUNICIPAL ISSUER BRIEF





Heading into this week, it's a mixed tone out there for issuers as far as pricing is concerned with the 10-year range looking more aggressive while sellers of longer-dated bonds may find it to be a more difficult environment.

MARKET UPDATE

THE PUERTO RICO FOG HAS BURNED OFF...FOR NOW: Traders, investors and underwriters were focused on Puerto Rico as its electrical utility is close to filing for bankruptcy. At first it affected the entire market, but fears began to ease as the week progressed.

INVESTORS & ISSUERS: New issues generally continue to do well.

- **Last week started out with difficulty** as mutual funds, facing redemptions, sold heavily into secondary markets, but a better Treasury market kept losses to a minimum.
- The modest new-issuance calendar did well and we expect the same this week. It was a tale of two markets as **new-issues were mostly re-priced to lower yields and competitive loans well bid,** while the secondary declined under pressure from Puerto Rico. (See **page 3** for more on regional deals.)
- Mutual funds that hold Puerto Rico debt saw some of their investors leave—forcing the funds to sell their Puerto Rico bonds, **but also to a large extent it forced them to sell their tobacco-backed municipal bonds and in some cases higher-rated bonds.**
- These higher-rated securities included California GOs, University of Utah revenue bonds and New York personal income tax bonds among others—and as a result these bonds traded cheaper in the secondary market. **This is an important lesson for all municipal issuers as to how the Puerto Rico concern can bleed into other issuers.**
- By the end of the week, though, a better Treasury market and a sense that the general market had weathered the Puerto Rico storm, **gave cover to investors to get more constructive on the market and rates improved modestly as a result.**
- For guidance on this week's market we will be closely monitoring **New York City's Transitional Finance Authority** deal and the $1B+ **Bay Area Toll Authority's** longer-dated, put-bond retail order period—likely the largest to sell outside of money market funds with a par coupon structure. **Early reads are positive.**

BUYERS BITES:

WHAT IS TRENDING HOT:
1) Longer California
2) Wisconsin GO
3) AMT bonds

CURRENTLY HARDER SELLS:
1) Puerto Rico
2) Tobacco

WHO IS REPORTEDLY BUYING:
Separately-managed accounts, regional banks, life insurance companies.

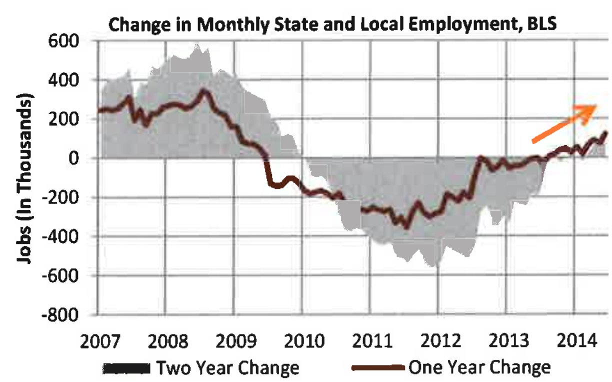


Figure 1: *The latest data out of the U.S. Bureau of Labor Statistics shows that in June this year, for the 11th consecutive month, state and local employment posted net increases. This is a good sign that states and localities are improving since the financial crisis. It is also a macro indicator that rating agencies monitor—among various other factors—in judging bond credit worthiness. Other recent data looked through in* ***Topic of the Week on Page 3*** *portray a mixed bag for state economies and offer insights into possible future rating actions.*

HIGHWAY TRUST FUND: Both the House Ways and Means and Senate Finance Committees last week approved 10-month, $10.8 billion transportation bills that would fund the Highway Trust Fund through May 31, 2015. Both bills fill the Highway Trust Fund with general and other funds but the Senate included some tax provisions that the House does not like. Both the House and Senate are expected to vote on the bills this week. If not approved, there would be a 28% reduction in transportation funding beginning August 1.

MMA The Power of Independence

TOPIC OF THE WEEK: STATE TRENDS

STATE TRENDS: A recent review of state budgets and various indicators reveals mixed messages on the condition of U.S. states' finances. In last month's Fiscal Survey of States by the **National Association of State Budget Officers** (NASBO), a generally favorable yet cautious tone is depicted with 42 of the 50 executive budget proposals recommending smaller spending increases in Fiscal Year 2015, meaning slower growth (2.9%) compared to 2014 (5.0%) and implying prudent governance. Looking ahead, however, NASBO notes that while states' combined mid-year budget gaps fell to a post-recession low of $4 billion across 13 states, "limited revenue growth and continued spending pressure for out-years" is generating $8.6 billion of projected gaps across 14 states, in large part because of Medicaid costs. **MMA**'s review through April for the 10 largest bond-selling states that report monthly data shows broad disparity. States such as TX, IL, CA and OH are reporting revenues above estimates (see **Figure 2**) as these states tend to set conservative projections, which translates into higher ending balances that position them favorably for a downturn. Alternatively, NJ, PA, FL and CT are seeing revenues flat or below estimates. In several cases, certain states' aggressive forecasts failed to adjust for one-time changes, such as the Bush tax cut expiration, which was the case in NJ, PA and CT where estimates lagged. These states will require late-year budget adjustments that are viewed as a credit negative by analysts.

An important component of any budget is the economic expansion of the state. The Philadelphia Federal Reserve compiles a data set tracking this. Importantly, 8 states account for about 50% of the U.S. GDP—CA, TX, NY, FL, IL, PA, OH and NJ. . New Jersey posted the weakest annual level of economic activity among the largest state economies but IL and NY also expanded at a rate lower than that of the aggregate U.S. economy (see **Figure 3**). Both NJ and IL have high unfunded legacy liabilities and insufficient recurring revenues to fund ongoing expenditures and neither was successful in addressing the issue in the latest budget process.

State	State Revenue (Through April) vs. Budget	Collections vs. FY2013
TX	+13%	+8%
IL	+10%	+2%
CA	+3%	+1%
OH	+3%	0%
NY	+1%	+12%
MA	+1%	+6%
CT	0%	-2%
FL	-1%	+5%
PA	-2%	0%
NJ	-4%	+2%

***Figure 2:** A review of the 10 largest issuing states' revenues vs. budget along with collections vs. fiscal year 2013.*

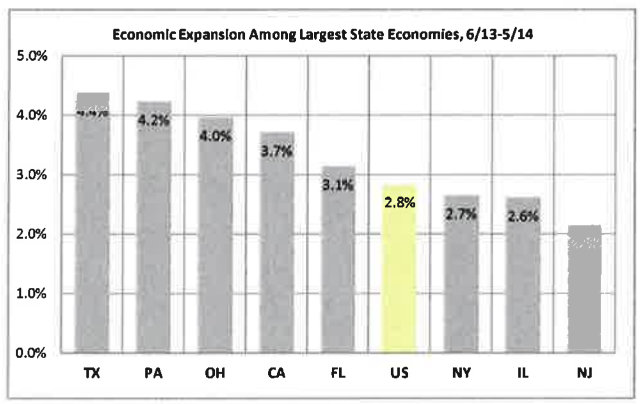


***Figure 3:** Eight states account for about half of the U.S. GDP. When one or more lag in economic expansion, if affects the national number.*

WHAT THIS MEANS FOR YOU: That the majority of FY15 state budgets are likely to see smaller spending increases is a generic credit positive for those states and affecting all issuers, implies less bond issuance in the next 12 months, helping to keep the supply/demand balance in favor of issuers. Still, consistent budget pressure surrounding programs, such as Medicaid, will keep municipal rating agencies focused on state revenue forecast performance. As a result, **MMA** suggests states report forecast data and critical investor information on a timely basis as revenue trends are likely collected internally by policymakers. We reviewed current monthly reporting across all 50 states and Puerto Rico and found that 35 states (69%) release monthly revenue data but only 23 states provide budget versus actual comparisons. Thirty-two (63%) provide year-over-year revenue data. Of the largest issuing states most release budgets versus actuals (CA, NY, PR, NJ, MA and IL) but there are notable exceptions: WA, VA, GA and MD. It can only help your rating and improve the relationship with your investors to report as much data as you review internally. As for broader economic growth, these are trends to monitor as they will ultimately affect how the state budgets impact localities and can be an effective tool in describing broader credit trends for local issuers whose state is seeing strong growth.

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

NORTHEAST

On July 9th, **Raymond James & Associates** priced $250 million of non-AMT revenue bonds for the **Massachusetts Port Authority**; Aa3/AA-/AA; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	3.00	1.44	+26
2024	5.00	2.67	+31
2034	4.00	4.01	+25

Notes: The issuer also priced AMT bonds, both series well received

MID-ATLANTIC

On July 10th, **Citigroup Global Markets Inc.** priced $212 million of revenue and refunding bonds in 3 series for the **Delaware River and Bay Authority**; A1/A/NR; callable in 10/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.56	+38
2024	5.00	2.93	+56
2044	5.00	3.92	+40

Notes: Sub-4% yield in 30-years is a success for the single-A rating

MIDWEST

On July 9th, **Wisconsin** sold $255 million of general obligation bonds to **Morgan Stanley & Co.**; Aa2/AA/AA; callable in 5/1/2020, except for bonds in 2027-2031, which are callable in 5/1/2022:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.37	+19
2024	5.00	2.11	-25
2031	5.00	3.07	-4

Notes: This competitive deal saw 11 bidders-above average for 2014

SOUTHEAST

On July 10th, **Morgan Stanley & Co.** priced $240 million of gasoline and fuels tax revenue bonds for **Louisiana**; Aa1/AA/NR; callable at par in 5/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2027	5.00	2.93	+24
2034	5.00	3.44	+16
2039	5.00	3.64	+17

Notes: The gas and fuels tax has not been issued in over 2-years

SOUTHWEST

On July 9th, **Bank of America Merrill Lynch** priced $171 million of water system revenue bonds for the **North Texas Municipal Water District**; Aa2/AAA/NR; callable in 3/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.40	+22
2024	5.00	2.59	+23
2034	3.75	3.69	+41

Notes: Lower, longer coupons did not impede this pricing

FARWEST

On July 10th, **Piper Jaffray** priced $22 million of revenue bonds for **Redmond Utility System, Washington**; NR/AAA/NR; callable in 12/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.49	+31
2024	5.00	2.56	+21
2034	3.60	3.74	+32

Notes: Par-ish bonds out long sparked strong interest

MCDC UPDATE

SEC'S MCDC GETS MORE PUSH BACK: Over the past few weeks, several municipal industry groups have been pushing the Securities and Exchange Commission (SEC) to further explain – and postpone the deadline for – the Municipal Continuing Disclosure Cooperative (MCDC) Initiative. Currently, issuers and underwriters must report by September 10 if there are any material misstatements in their Offering Statements (OS) related to past compliance with outstanding continuing disclosure agreements for bonds issued over the past 5 years, (see May 27th MIB for more). The BDA has formally asked for an extension of the deadline until December 15, and a similar request from other groups is expected this week. However, the SEC has stated that it is not inclined to change the deadline. Another concern is that the SEC will not define "material," which would help issuers and underwriters clearly understand whether they need to self-report. Further, last week the SEC settled its first MCDC case with the Kings Canyon Joint Unified School District (CA), but did not articulate exactly what the school district violated. Instead the SEC said that the district failed to submit "some disclosures." Many have noted that the SEC's lack of clarity is making it difficult for issuers and underwriters to decide whether and what to self-report, with the deadline fast approaching.

To help issuers better understand the MCDC Initiative, the GFOA posted an alert on its website that both explains the program and provides a roadmap of questions issuers should be asking if they've issued bonds in the past five years and determine if they need to self report to the SEC. The Council of Development Finance Agencies will be hosting a free webcast tomorrow to discuss considerations related to the Initiative.