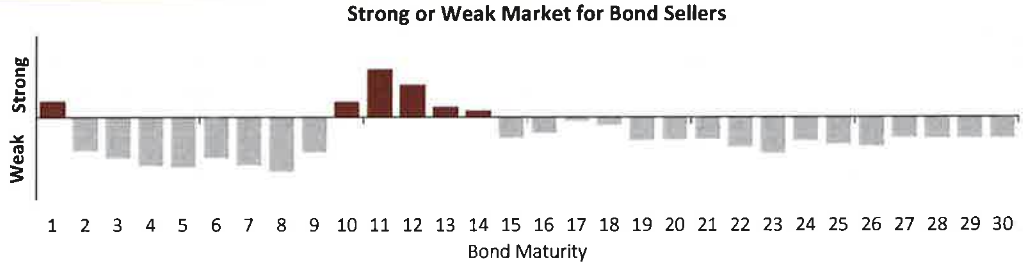
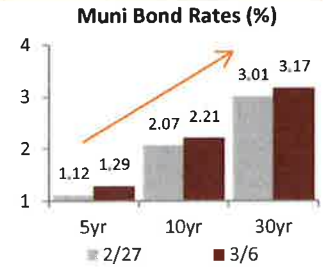
MMA Independent & Data Driven

MARCH 9, 2015

MUNICIPAL ISSUER BRIEF





Heading into this week, the challenging dynamic across much of the yield curve remains in place but the data is showing a better pricing opportunity just outside of 10-years and is something that issuers should consider taking advantage of.

MARKET UPDATE

IT'S A SEASONALLY DIFFICULT MARCH: Municipal bond issuers encountered a challenged dynamic last week as borrowing rates generally increased and economic indicators released on Friday could make the coming week even more difficult.

INVESTORS & ISSUERS: Buyers could demand cheaper prices:

- Nearly every day last week reflected higher **tax-exempt yields** (cheaper) under the pressure of a weaker Treasury bond market, and a robust supply of taxable and tax-exempt primary issues.
- This poor market conditions enabled municipal investors to command more yield during bond pricings. Indeed, several of the week's deals that **MMA** monitored had to re-price to higher yields (see **page 3** for more details on **California**, **Maryland** and the **Florida Board of Education**).
- Secondary selling pressure from a few large mutual fund companies was also challenging for issuers. The specific pressure was in the 5- to 10-year part of the curve. If this pressure continues **issuers of shorter-maturing bonds will be competing with these funds for buyer attention**. It is therefore **very important for issuers to be aware of mutual fund flows this week.**
- This week features the largest new-issue calendar of 2015 (see **Figure 1, right**) which could put issuers at a disadvantage with so many deals for investors to consider and dealers to underwrite.
- Additionally, on Friday after the nonfarm jobs data, the Treasury market sold off to its greatest degree since July 2013. Tax-exempt yields also rose, but not as much—meaning that underwriters will contend with an adverse environment.
- One positive last week was the buying presence of insurance companies. Most notably, about half of Maryland's $365 million GO deal matured entirely in 2023 with a 4% coupon. Household name insurers were large buyers there, and **other issuers coming to market could structure their deal to suit these interests**.

TREASURY TO CLOSE SLGS WINDOW: Keep an eye on Congress this week. If they fail to increase the U.S. debt limit, the Treasury Department has announced that at noon eastern on March 13, the state and local government securities (SLGS) window will close. Closing the SLGS window means that state and local governments will not be able to purchase SLGS until the Treasury resumes the program (following Congressional increase of the debt limit). Issuers should plan accordingly as the ambiguous political winds remain in D.C..

BUYERS BITES:

WHAT IS TRENDING HOT:
1) IG 4% coupons in 10 to 15 year range
2) Short calls continue to outperform

CURRENTLY HARDER SELLS:
1) Shorter maturities
2) California GO trades cheaper

WHO IS REPORTEDLY BUYING:
Insurance companies, Mutual funds, SMAs

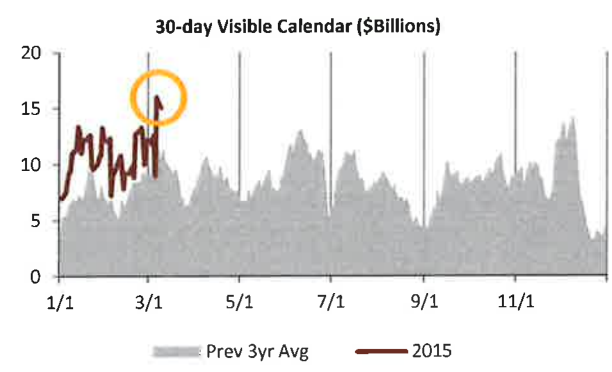


Figure 1: *The 30-day visible supply compiled by The Bond Buyer newspaper is a good indicator of scheduled municipal bond deals. On Friday last week the volume surpassed $16 billion—the highest amount since December of last year. The chart above illustrates the 2015 visible supply in the maroon line compared to the 3-year average (grey shaded area). Note that March is historically a high-issuance season that can make pricing a bond deal more difficult, and has coincided with the municipal market's poor seasonal price history for the month. Since 1990,* ***MMA****'s municipal price index has only posted a cumulative gain in the month of March 5 times.*

TOPIC OF THE WEEK

CHALLENGES FOR STATE AND LOCAL GOVERNMENTS: "Fiscal sustainability presents a national challenge shared by all levels of government," begins a recent report from the U.S. Government Accountability Office (GAO). The GAO report bolsters **MMA**'s view that absent significant policy changes, long-term expenditures pressures—including Medicaid and retiree healthcare—represent a major challenge for state and local governments. Unaddressed, these growing costs will constrain investment in other budget priorities, including the areas of education and infrastructure that are critical to future economic growth.

Even as the national economy continues to improve, state and local revenues are not keeping pace with expenditure growth. The GAO projects this trend to continue. According to the GAO's analysis, state and local revenues—as a percentage of GDP—are expected to remain below 2007 (or pre-crisis) levels until 2058, but healthcare costs are expected to nearly double to 7.4% of GDP by 2060. Closing the fiscal gap projected by the GAO would require that governments cut and maintain an 18.0% reduction in expenditures or raise an equivalent amount of revenue for the next 50 years. Lower levels of government are also at risk of additional challenges from intergovernmental aid cuts and costs shifts, as higher levels of government address their fiscal issues.

WHAT THIS MEANS FOR YOU: Generally positive market conditions for municipal bond issuers over the last 15 months has mostly trumped investor concerns over fiscal challenges facing governments, meaning little to no effect on market access (e.g. cost of borrowing). Many issuers, even those who already are facing the challenges highlighted in the GAO report, have maintained the ability to raise capital at historically low levels. **However, issuers' access to capital may change as market conditions are altered by monetary and legislative policies, challenged by the stresses from healthcare, revenues, and pensions costs, and are covered more robustly by the media.**

Interest rates are projected to move higher over the next few years from the recent historically low ranges. A weaker rate environment is apt to lead to wider spreads and greater investor differentiation among issuers based on fundamental forces. **This means investors are likely to require a higher interest rate (wider spread) on the debt of those issuers that are falling behind in getting expenditure growth under control.** The effect is apt to be more pronounced on the unsecured bonds of these issuers in the wake of the severe haircuts—recoveries well below par—imposed on these instruments in the bankruptcies of Detroit, Michigan and Stockton, California. The security for these bonds was undermined, in part, by the failure of the issuers to address escalating pension and retirement healthcare costs. For those issuers with a structural budget gap that is projected to grow, a strategy or a response should be developed.

With these topics in mind, it is more important than ever for issuers to be transparent about their fiscal challenges and make investors aware of information that is already developed related to current budgets, forthcoming budgets and liabilities. The more information that is available from issuers will help build strong relationships with the investor community, and increase the potential demand for bonds when a new issuance comes to market. Improved disclosure and communication efforts can also assist the secondary transactions of an issuers outstanding bonds, which are more important to pricing of primary issues than in the past (because of the fiduciary responsibility imposed by regulators on Municipal Advisors (MAs). To that point, governments may want to look at the investor conference the Commonwealth of Massachusetts held in December 2014, at which many of the issues related to issuer/investor communications were discussed.

REGULATORY UPDATE

MCDC NEWS: Last week, the head of the Securities and Exchange Commission's (SEC) enforcement division told a National Association of Bond Lawyers (NABL) conference audience that the office is contacting dealers that self-reported Municipalities Continuing Disclosure Cooperation (MCDC) program violations last year and giving them 2 weeks to determine whether they want to take advantage of the SEC's offer to settle the violations. If dealers do not settle, then regular enforcement actions may come into effect. This recent SEC activity does not pertain directly to issuers, but does involve the bond deals that were self-reported by dealers. Staff also said the MCDC initiative and forthcoming violations will provide insight into the types of absent continuing disclosure it deems material. Bond lawyers and others in the market have expressed concern that the SEC has not been specific enough about what it deems "material disclosures" in its recent enforcement actions and the MCDC program.

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

- **California** sold nearly $2 billion general obligation bonds last week. The state received almost $600 million in retail orders Monday, but had to cheapen prices as the general market turned negative (as measured by MMD's subjective benchmark scales). On Tuesday with cheaper yields, institutional investors placed significant orders and eventually the state was able to lower costs slightly before the end of the day.
- Last week triple-A and benchmark-influencer **Maryland** GO sold 2 large competitive deals to Bank of America and Citigroup. Each deal was bid slightly cheaper than prevailing AAA rates that day and helped to justify a cheaper general market (MMD and evaluation models). The Citigroup issue (not featured below) had 4% coupon tailored to large insurance companies.
- The **Florida Board of Education** saw bidding on par or even firmer than the issuer's January deal, as underwriters competed for the state's business. The underwriter struggled with maturities around 10-years in the aftermath of the sale.

NORTHEAST

3/2: **Roosevelt & Cross Inc.** priced $13.3 million limited general obligation bonds for **Rensselaer County, NY**; NR/AA/NR; callable at par in 9/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.46	+31
2025	5.00	2.21	+12
2028	3.00	2.95	+60

Notes: The 9-year call option benefited the issuer in 10-years

MID-ATLANTIC

3/4: **Maryland** sold $518 million general obligation bonds to **Bank of America Merrill Lynch**; Aaa/AAA/AAA; callable at par in 3/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2018	5.00	0.90	+15
2020	5.00	1.33	+13
2025	5.00	2.08	-4

Notes: The interest in short-call or kicker bonds continues

MIDWEST

3/4: **Stifel Nicolaus & Co.** priced $30.8 million limited general obligation bonds for **Ottawa County, Michigan**; Aaa/NR/NR; callable at par in 2/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.48	+28
2025	5.00	2.39	+27
2032	5.00	3.00	+32

Notes: MI issuers still have to differentiate themselves from Detroit

SOUTHEAST

3/3: The **Florida Board of Education** sold $234 million Florida public education capital outlay refunding bonds to **JPMorgan Securities LLC**; Aa1/AAA/AAA; callable at par in 6/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.11	+16
2025	5.00	1.89	+4
2029	3.00	2.75	+58

Notes: the 3% coupon in 2029 was geared toward an insurance co.

SOUTHWEST

3/4: **Piper Jaffray & Co.** priced $47.1 million general obligation bonds for the **McKinney Independent School District, Texas**; Aa2/AA/NR; PSF (Aaa/AAA/NR); callable at par in 2/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.46	+26
2025	5.00	2.33	+21
2030	4.00	3.05	+52

Notes: Texas PSF enhancement helps lower costs

FARWEST

3/4: **Bank of America Merrill Lynch** priced $1.9 billion general obligation bonds for **California**; Aa3/A+/A+; callable at par in 3/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.43	+23
2025	5.00	2.38	+26
2045	5.00	3.27	+21

Notes: The state also offered various par-coupon structures