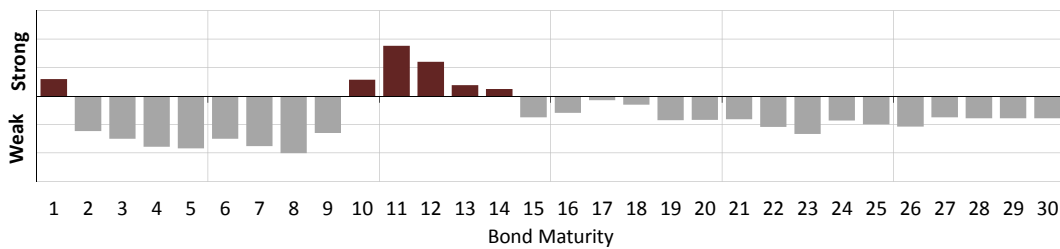
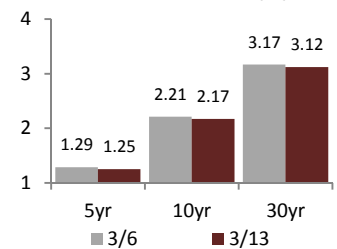


MUNICIPAL ISSUER BRIEF

Strong or Weak Market for Bond Sellers



Muni Bond Rates (%)



Heading into this week, the pricing dynamic has shifted to a generally more challenging one after last week's gains. Still, the latter half of March tends to have a positive bias as investors look to quarter-end statements.

MARKET UPDATE

AFTER SLOW START, PERFORMANCE IMPROVES: Municipal rates ended modestly lower on the week but only after investors resisted the move on Monday and Tuesday. Eventually the tide turned in favor of issuers as worldwide bond markets improved.

- INVESTORS & ISSUERS:** International events help U.S. municipalities
- **Market participants started last week with hesitancy**—it was faced with the largest new-issue calendar of the year and broader interest rates had been rising.
 - On Monday and Tuesday Treasury bonds rallied with Eurozone bonds, **but tax-exempt investors were not willing to follow**. This made some of the new deals priced in the start of the week somewhat more challenging (see [page 3](#) for more on that).
 - By midweek the market finally began to follow other bond markets lower and **this greatly benefited issuers**—especially ones that came competitively such as Clark County, Nevada ([page 3](#)).
 - Note that this week's calendar is 71% refundings by our tally and the third week in a row in which refundings account for more than two-thirds of all scheduled issuance—a **positive dynamic for issuers**. [Figure 1](#), right, takes a look at year-to-date supply and the role refundings have played.
 - One area of concern is the mutual fund space, which has seen a slow down in the cash flowing into their funds. Most underwriters have day-to-day information on this—it is **something an astute issuer can ask about**.
 - Also, we continue to see a few large mutual funds' selling their shorter bonds, mostly in the 5- to 10-year range, likely in anticipation of that part of the market performing the worst when the Federal Reserve does decide to raise interest rates.
 - **European banks** are buying high-grade GOs—ask an underwriter.

BUYERS BITES:

- WHAT IS TRENDING HOT:**
- 1) Large state GO blocks
 - 2) Lower-rated IG healthcare
 - 3) Multi-family housing

- CURRENTLY HARDER SELLS:**
- 1) Bonds in the 5- to 10-year range

WHO IS REPORTEDLY BUYING:
Insurance companies, European banks, large domestic banks and small community banks

Cumulative Weekly Municipal Bond Issuance (\$B)

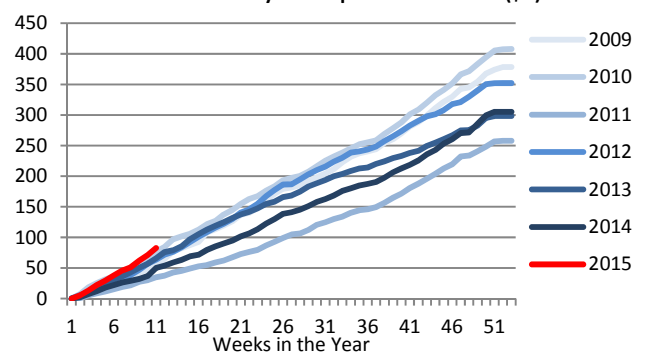


Figure 1: Issuance thus far in 2015 is outpacing every year going back to 2009 at the least. Fueled by issuers taking advantage of low interest rates, refunding deals have led the way. In fact, through the first 11 weeks of this year, 2015 is \$21 billion above the 3-year moving average through this same time period. More supply tends to tip the supply/demand dynamic in favor of investors and not issuers but it is not so clear cut in 2015. Investors have their bonds called for refundings and in many of these situations will reinvest in the market.

GALLAGHER LINKS PENSIONS TO EXEMPTION: Last week, SEC Commissioner Daniel Gallagher spoke to the Financial Industry Regulatory Authority's (FINRA) conference and said that Congress should mandate issuers use of Governmental Accounting Standards Board (GASB) standards, possibly as a condition of a bond's tax-exempt status. Gallagher spoke at length about the SEC's initiatives in the municipal space, including increased transparency for retail investors and enforcement initiatives (MCDC, issuer official fraud, among others). His speech can be found [here](#). As **MMA** noted in the past, the SEC has increased its attention to the municipal market and we will delve further into the regulatory environment in a future **MIB**.

TOPIC OF THE WEEK: PENSION OBLIGATION BONDS

PENSION OBLIGATION BONDS—WHY YOU SHOULDN'T ISSUE THEM: Bonding out pension obligations has become an increasingly discussed topic in the public finance arena in recent months. Multiple states, such as Kansas, Kentucky and Pennsylvania, as well as several local governments (mainly in Michigan) have either sold or proposed the sale of pension obligation bonds (POBs). These are taxable bonds sold by an issuer to pay for current obligations to a pension fund or other post-employment benefits, in essence deferring current costs through bonding to be paid at a later date, plus interest. **MMA** views POB issuance as a reckless employment of operating leverage. Additionally, the Government Finance Officers Association (GFOA) [recently updated](#) its Pension Obligation Bonds Advisory and recommends that state and local governments do not issue POBs. Four key issues with POBs:

- To pay for the debt service associated with a POB, the pension fund's returns must outpace the bond's interest rate. Regardless of asset allocation decisions by the fund, this is a challenging task, especially in today's market context wherein corrections approach 10% and structurally slower economic growth. These hard targets may make pension fund managers more aggressive. Note several funds have allocated to hedge funds in recent years ([but are now reconsidering](#)), which can put funds at further risk as some of these funds are aggressive risk/reward managers. In other words, the ability to pay the debt relies on a very successful track record of investment over numerous years with taxpayer dollars at risk.
- The bonds are often used by governments more interested in near-term relief for contributors to the pension system over long-term liability management. To boil it down: POB users are willing to gamble with future, long-term costs so as to avoid raising revenues or cutting expenses in the present. Pushing off hard decisions now only adds to the cost of making them later. It implies a strong degree of political interference with budget-management decisions.
- POBs can short-circuit benefit reform by appearing to solve pension funding issues in the near-term. While extremely challenging for governmental entities currently undergoing pension reform, a positive out of the focus on this area has been a more transparent view of the real costs of pension benefits to public entities.
- New Governmental Accounting Standards Board (GASB) pension account standards contain a more favorable treatment of better-funded pensions and on the surface POB issuance boosts balances. At present, issuers may be turning to POBs with the GASB standards in mind *to appear* to be better funded. Accounting standards are a terrible reason to take on new debt.

WHAT THIS MEANS FOR YOU: **MMA** noted to our institutional clients last week that [if a state or local government uses pension obligation bonds that it is a solid reason to consider a rating downgrade](#) to that entity's creditworthiness, all else being equal. A rating downgrade should increase any issuer's borrowing costs. That pension obligation bonds are being discussed by various states and cities as a viable option to address pension issues, and that it is gracing the pages of the mainstream and financial media, adds headline risk to the entire market. **MMA** expects the asset management community to begin to weigh pension obligations in increasing fashion when making municipal bond investment decisions in the near-term. Perhaps most important, in our default-modeling exercises, **MMA** projects a slightly higher default incidence for issuers who have sold POBs in the past—a stigma to avoid.

TAX REFORM & SLGS WINDOW

SENATE FINANCE SEEKING INPUT ON TAX REFORM: The Senate Finance Committee last week [announced](#) it was seeking public input to its 5 working groups' efforts on tax reform ideas. Each of the 5 working groups is looking at current tax policy and creating legislative recommendations within its area, with the goal of having recommendations by the end of May. The Committee leadership said that submissions will be reviewed by the working groups and ideas can be incorporated into final recommendations. The working group on Community Development & Infrastructure, which will include municipal bonds and all infrastructure items within the tax code, is the focus for the municipal market. Having met with pertinent staff on the Hill, **MMA** [views these groups with skepticism that have thus far accomplished little and have a tight timeframe to offer anything of substance.](#)

Still, this creates an opportunity for interested parties to supply

ideas for the Committee that could bolster a positive conversation about the industry. Although the state and local government associations will most likely be submitting letters to support maintaining the tax-exemption, individual issuers can also submit comments. Governments would be well served to discuss specific bond projects done in their jurisdiction to show the value of the tax-exemption and access to the bond market. Comments can be sent to CommunityDevelopment@finance.senate.gov and will be received until April 15. For more on the working groups, see the January [issue](#) of **MIB**.

DEBT CEILING & SLGS: Meanwhile, the Treasury Department [announced](#) on Friday that it closed the State and Local Government Securities (SLGS) window because Congress did not raise the debt ceiling. The Treasury calls closing the window an "extraordinary measure" and it is at least the 10th time it has had to use it in the past few years.

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

- Through the first day of retail orders, **New York City** put away one-third of its deal to individuals—a strong start. The City found particular retail interest in its par coupon offering in 2035 that was eventually lowered 5 basis points in yield. By the conclusion of the deal, though, the issuer had to adjust some yields slightly higher as the general market struggled to follow taxable market gains in the beginning of the week.
- High-grade competitive issues saw strong bidding, including **Clark County, Nevada**, which many market observers viewed as a signal that dealers were going to be more aggressive and this helped turn the tide into a stronger latter half of the week.
- The **University of California** offered nearly \$2 billion taxable and tax-exempt bonds last week on the tail of a similarly sized California GO issue the previous week. Because the University priced mid-week when the general market began to see improvement, the issuer was able to lower yields slightly during re-pricing despite the increase in the states' issuance of late.

NORTHEAST

3/12: **RBC Capital Markets** priced \$800 million general obligation bonds for **New York City**; Aa2/AA/AA; callable at par in 2/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.76	+47
2025	5.00	2.66	+46
2035	3.60	3.60	+68

Notes: A decent ROP helped moved things along to institutions

MID-ATLANTIC

3/9: **Wells Fargo Securities** priced \$50.5 million general obligation bonds for **Henrico County, VA**; Aaa/AAA/AAA; non-callable:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.51	+22
2025	5.00	2.26	+5
2028	5.00	2.82	+35

Notes: Non-call 5s outside of 10-years are not a common structure

MIDWEST

3/11: **Florence, KY** sold \$6.2 million general obligation bonds to **Raymond James & Associates**; Aa1/NR/NR; callable at par in 6/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2015	1.00	0.30	NA
2020	2.00	1.45	+16
2027	2.50	2.25	-16

Notes: These low coupons went to buy-and-hold customers

SOUTHEAST

3/10: **Delray Beach, FL** sold \$39.2 million utilities tax revenue refunding and improvement bonds to **Fidelity Capital Markets**; Aa3/AA-/NR; callable at par in 6/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.63	+34
2025	5.00	2.47	+26
2035	3.50	3.55	+61

Notes: As NYC did, par coupons in 2035 found strong retail interest

SOUTHWEST

3/10: **Clark County, Nevada** sold \$181 million limited tax general obligation flood control refunding bonds to **Bank of America Merrill Lynch**; Aa1/AA/NR; callable at par in 5/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.88	+59
2025	5.00	2.58	+37
2035	4.00	3.70	+76

Notes: Lower coupons out long came at the behest of insurance cos

FARWEST

3/12: **Barclays Capital Inc.** priced and re-priced \$1.23 billion limited project revenue bonds for the **Regents of the University of California**; Aa3/AA-/AA-; callable at par in 5/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.59	+30
2025	5.00	2.44	+24
2045	4.00	3.76	+62

Notes: Bumped 2 to 5 basis points during re-pricing