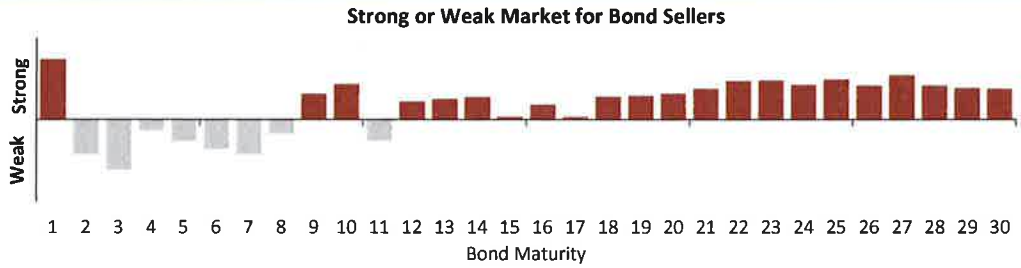
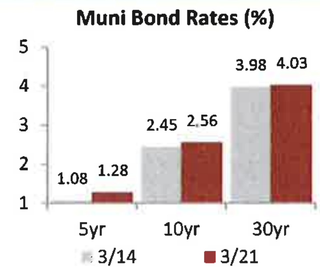
MMA The Power of Independence

MARCH 24, 2014

MUNICIPAL ISSUER BRIEF





Heading into this week, the sell-off in the short-end is portrayed in the above chart with those maturities moving swiftly into the "weak" section. Still, longer maturities were able to mostly withstand headwinds and offer relative value to issuers this week.

MARKET UPDATE

THE MARKET FOR BONDS MATURING IN 10-YEARS OR LESS TOOK A TURN FOR THE WORST: Speculation on what the Federal Reserve might do next—and the affect on interest rates—played a big role in the market activity of the latter half of last week.

INVESTORS & ISSUERS: A new dynamic developed last week.

- **Issuance remains on the lower side this week.** Once again bond issuance is well below recent averages for this time of year.
- Last Wednesday, the Federal Reserve gave itself more wiggle room to eventually raise interest rates. On Thursday and Friday, short maturities of the U.S. Treasury market responded with a violent move to higher yields and **municipals followed to dramatically higher yields for bonds maturing around 5-years** (see Figure 1) as mutual funds and other money managers sold their shorter holdings. **Issuers of shorter bonds should take note as their borrowing rates likely have increased.**
- **Longer maturities were generally able to withstand the sell-off in short bonds**—most notably was California GO.
- **Interestingly, this week, refundings represent a larger portion of issuance** led by a large California prison refunding. Issuers taking advantage of low interest rates in recent years were able to refund older deals. This has slowed down considerably since last summer.
- Speculative grade Pace University and single-A McCarran airport were able to lower their yields last week (by as much as 20 basis points for Pace) as investors crowded into higher-yielding sectors. **Other lower-rated issuers may take advantage of this current trend, especially if offering yields > 3.00% in '24.**
- **Competitive deals last week saw strong dealer bidding.**

MSRB RULES VIOLATED: Over the course of the last 1 1/2 weeks there have been more than 100 trades of the new Puerto Rico GOs that violated MSRB rules (as first reported by the Bond Buyer). To prevent (and protect) retail investors from purchasing the bonds, Puerto Rico specified in their Official Statement that the bonds could not be traded in denominations smaller than $100,000. Trade data given directly to the MSRB show that trades have occurred in violation of the issuer's OS. It appears as though the MSRB was not aware of these violations when they occurred. The MSRB and FINRA are now looking into it. Issuers should closely monitor how the regulators address the rule violations especially since they happened when the issuer expressly stated the type of prohibited trade for its deal.

BUYERS BITES:

WHAT IS TRENDING HOT:

1) Competitive deals
2) California GO
3) Lower-rated higher education, airports

CURRENTLY HARDER SELLS:

1) Bonds maturing in 4 to 7 years
2) Puerto Rico

WHO IS REPORTEDLY BUYING:

Large banks, separately managed accounts, investors who tend to purchase corporates or sovereign debt

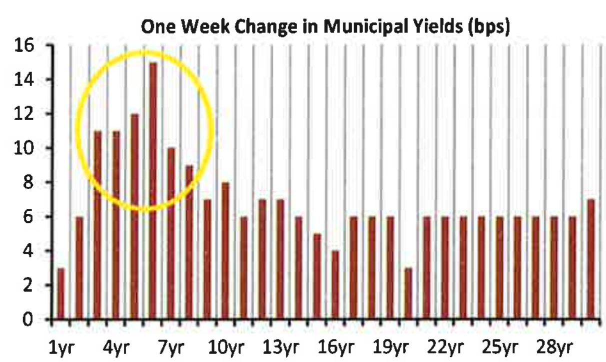
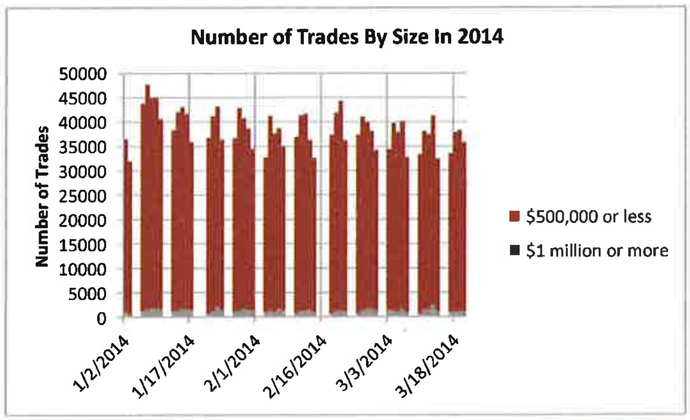


Figure 1: *The market for shorter bonds took a big hit on Thursday and Friday of last week as broader rate markets also saw yields increase significantly in the wake of the latest Federal Reserve meeting. Most issuers will see their borrowing costs rise on their shorter obligations in the near-term as a result of this market move. In addition, the MMD rate-lock market may amplify upward pressure on interest rates, as alternative accounts with incentives to move MMD to higher yields at quarter-end (to increase their unrealized gains and incentive fee compensation), could artificially raise borrowing costs of issuers in the upcoming week.*

TOPIC OF THE WEEK: BEST EXECUTION

PROPOSED NEW RULES: Recently the Municipal Securities Rulemaking Board (MSRB) requested comments on a proposed requirement that broker-dealers provide best execution when trading with unsophisticated customers. It is designed to protect smaller investors who may have more difficulty making informed investment decisions in the $3.7 trillion municipal market. Under the new rule, firms would need to have a process in place to evaluate all reasonable venues for a particular customer trade and execute on the best price that that process reveals. The rule mostly runs to operational issues: it would require firms to build out the technology to make broader trading venue information available to employees trading with retail clients and the related compliance mechanisms to oversee that procedures are being followed.

WHAT THIS MEANS FOR YOU: The extent to which the rule winds up favoring best price over speed (which can be critical for issuers going through a pricing) it could result in forcing an underwriter to hold your bonds longer. **This would likely encourage higher yields and higher borrowing costs**. The cost of it taking longer to execute a trade to move a bond to a customer will be passed on to the issuer. To minimize this effect, issuers should first get the best possible grasp on who buys their bonds. If you are an infrequent, lower-rated, or perhaps only bank-focused issuer, this rule will have less effect on you — as the underwriter will not have to interact with many unsophisticated investors. If you are a high-grade, frequent issuer who puts an onus on retail order periods, this rule could have a greater impact on your pricing. In that case, consider the business model of your underwriters. Firms have different customer bases and as this rule gets closer to becoming final, issuers could include questions in their request for proposals surrounding how the underwriter has addressed the best execution rule and built out a new system to meet the rules. This rule is a moving target. Various advocacy groups have attempted to make the case that it is impossible to truly provide best execution for all investors given the over-the-counter nature of the municipal market and its inconsistent liquidity. However, the impact of the post-financial crisis regulation is now starting to be felt, and all issuers—frequent and infrequent—will be affected in the near-term. The chart to the right breaks down the number of trades this year in two different sizes. Note how much more common transactions of $500,000 or fewer are compared to larger trades, those greater than $1 million. The smaller trades are much more likely to occur with unsophisticated investors where best execution would apply.



ISSUER GROUP ROUND-UP

GFOA REVISES, DEVELOPS DOCUMENTS ON NEW SEC, MSRB RULEMAKING: While the Securities and Exchange Commission's (SEC) new Municipal Advisor (MA) Rule does not directly impose regulations over municipal issuers, and the regulations are imposed upon municipal advisors, underwriters and other outside professionals, there are many implications for issuers. To address how the MA rule will affect issuers' policies and procedures for hiring outside professionals, the GFOA has updated its best practices, *Selecting and Managing the engagement of Municipal Advisors* and *Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales*.

The updates to these best practices continue to recommend that issuers use an RFP process and have policies and procedures in place when hiring outside professionals. A new section in the Best Practice (BP) related to MAs is for the issuer to clearly state in a contract the scope of work it wishes to receive from its MA. In the BP on selecting underwriters in a negotiated bond sale, revisions include a suggestion that an issuer may wish to sign a non-binding letter of intent with the underwriter at an earlier state of the transaction than the traditional Bond Purchase Agreement signing, to allow for certain exemptions within the SEC MA Rule to apply when an issuer is engaged with an underwriter for a specific transaction. This BP also notes the changes in underwriter practices attributed to MSRB Rule G-17, which places new disclosure requirements on underwriters to their issuer clients. The GFOA's Governmental Debt Management Committee developed an MSRB Rule G-17 Alert for its members. The Alert explains the Rule and how the new criteria related to the disclosures an underwriter must provide to issuers should be viewed and interpreted. The Alert also provides model language issuers may wish to use when they choose to acknowledge these disclosures in writing back to the underwriter.

STATE TREASURERS MEET IN DC: The National Association of State Treasurers (NAST) held their annual DC meeting last week. Of note, SEC Municipal Division Chief John Cross spoke abut the importance of the SEC's new MA Rule that goes into effect July 1. He emphasized that issuers remain, and should, be in charge of if, when and how they engage the services of an MA. Cross also said there are many ways in which issuers can receive advice and information from those without a fiduciary duty, which was a point of interest and concern for many of the treasurers in attendance. Market experts also spoke about new tax reform initiatives and the threat to the tax exempt status of municipal securities.

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

NORTHEAST

On March 19th, **Citigroup Global Markets Inc.** priced $30 million of MassDirect notes general obligation bonds for **Massachusetts;** Aa1/AA+/AA+; not callable:

Maturity	Coupon	Yield	+/- AAA 5%
2017	3.00	0.56	+12
2024	4.00	2.62	+17
2024	5.00	2.62	+17

Notes: This deal was marketed directly to retail investors via TMC

MID-ATLANTIC

On March 19th, **Raymond James & Associates** priced $74 million of water and sewer revenue bonds for the **Henrico County Water and Sewer Authority, Virginia**; Aa1/AAA/AAA; callable in 5/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	1.50	1.15	+12
2024	4.00	2.58	+13
2039	4.00	4.03	+12

Notes: Highly rated, this deal saw strong retail interest

MIDWEST

On March 19th, **Jefferies LLC** priced $159 million of electric system revenue bonds for **Holland, Michigan**; Aa3/A/NR; callable in 1/1/2021:

Maturity	Coupon	Yield	+/- AAA 5%
2019	2.50	1.45	+29
2024	3.00	3.18	+73
2039	5.00	3.95	+4

Notes: The kicker structure (short calls) saw enhanced interest

SOUTHEAST

On March 20th, the **Florida Board of Education** sold $107 million of capital outlay general obligation bonds to **Morgan Stanley & Co. LLC**; Aa1/AAA/AAA; callable in 6/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.37	+12
2024	5.00	2.70	+18
2026	3.00	3.17	+33

Notes: This issuer captured low rates just before the market decline

SOUTHWEST

On March 19th, **Goldman Sachs & Co.** priced $128 million of junior lien wastewater system revenue refunding bonds for the **Phoenix Civic Improvement Corp. Arizona**; Aa2/AA+/NR; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.76	+30
2024	5.00	2.97	+43
2028	5.00	3.38	+21

Notes: This deal was re-priced as much as 10 basis points on its 15yr

FARWEST

On March 18th, **Citigroup Global Markets Inc.** priced $110 million of sales tax revenue bonds for the **San Bernardino County Transportation Authority, California**; Aa2/AAA/AA+; callable 3/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2016	4.00	0.32	+22
2019	5.00	1.29	+19
2023	5.00	2.65	+35

Notes: The County was not afflicted by the city's credit problems