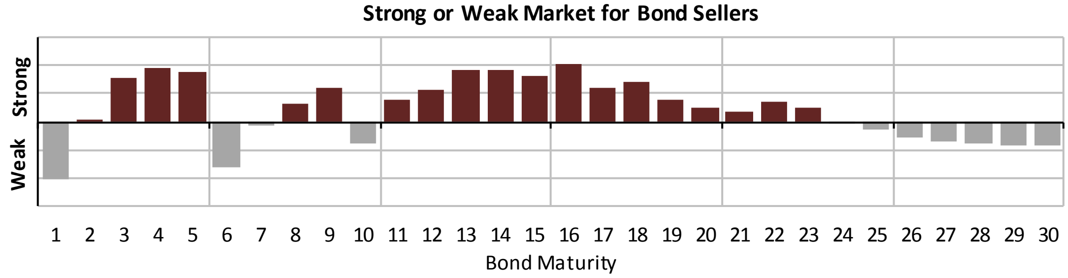
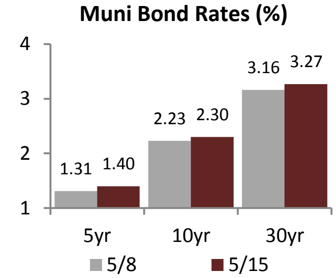
MMA Independent & Data Driven

MAY 18, 2015

MUNICIPAL ISSUER BRIEF





Heading into this week, sustained losses throughout much of May has finally produced some opportunity for issuers in some areas of the yield curve. After a decidedly negative pricing dynamic, we see more strong columns emerging, especially in the intermediate portion of the yield curve.

MARKET UPDATE

NEGATIVE HEADWINDS LINGER: A big week of issuance faced continuing headwinds last week that remain in place for this week's big slate. Even as bond markets worldwide moved to lower interest rates, tax-exempt municipals were unable to follow.

INVESTORS & ISSUERS: Important credit themes affect all:

- Municipal bond markets were little changed to just cheaper from the macro perspective but if we look a little closer, there are important **negative headwinds to consider that** have implications over the next few months.
- Perhaps most telling, U.S. Treasury rates, which municipals follow most closely, moved into lower ranges along with European bond markets, **but tax-exempts were unwilling to follow**.
- This was in part because issuance continues to be very high—around $9 billion per week lately—and underwriters are having **difficulty finding investors.**
- Additionally, Chicago's downgrade to below investment grade status by Moody's Investors Service has stoked the fires of municipal credit concerns.
- Retail investors were a big seller of various Chicagoland credits, even those that were not affected by the downgrade, driving yields higher by as much as 50 to 150 basis points.
- The contagion spread beyond the state line, as New Jersey appropriation debt cheapened 40 basis points and **MMA** observed the early signs of Pennsylvania, Louisiana, Mississippi and Rhode Island debt trading to higher yields in the secondary markets. All these states have budget hurdles and are being negatively affected by Chicago's woes.

CHICAGO DOWNGRADES: Chicago, IL was downgraded to below investment grade by Moody's Investors Service last week. As we noted above, this news is important as the headline risk from these downgrades of the **third largest** U.S. city has inevitably reverberated across the municipal industry. Headline risk is most severe for other states and cities with credit profiles similar to Chicago. While **MMA** still believes that Chicago is not a Detroit or another similarly distressed city, there will be headlines that will hurt the industry on the whole. Issuers should follow the news out of the Midwestern city and be sure to differentiate themselves to investors. Additionally, Chicago's woes will been seen in Washington, D.C., which is polarized as ever, and may create political headwinds for state and local governments on the whole. See **page 2** for more on happenings in D.C.

BUYERS BITES:

WHAT IS TRENDING HOT:
1) CT, PA Turnpikes Break Stronger

CURRENTLY HARDER SELLS:
1) Chicagoland, Illinois
2) New Jersey appropriation
3) Pennsylvania and even Rhode Island

WHO IS REPORTEDLY BUYING:
Insurance companies, SMA

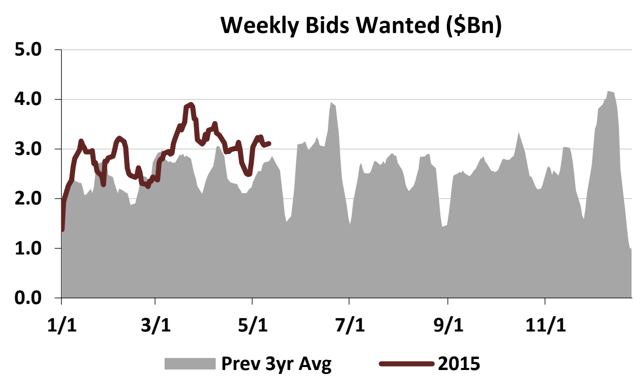


Figure 1*: Aside from the big new-issue volume, secondary market selling pressure remains well above the 3-year average—maroon line above. When asset managers sell their municipal investments in the secondary market, it competes for investor attention for new-issues in the primary market.*

TOPIC OF THE WEEK: WASHINGTON, D.C. ROUNDUP

Increasing Bank-Qualified Limit. Rep. Tom Reed (R-NY) and 5 cosponsors introduced bipartisan legislation (H.R. 2229, the *Municipal Bond Support Act of 2015)*, that would increase the bank-qualified (BQ) limit from $10 million to $30 million, and going forward index the amount to inflation. BQ debt is often used by small governments who do not issue more than $10 million of bonds a year and helps them avoid some of the debt-issuance costs when they place their debt directly with banks. Banks, in turn, get a federal tax break to finance the debt. The amount has never been increased, aside from two years when the American Recovery and Reinvestment Act (ARRA) was implemented in 2009-2010. For these two years, many governments took advantage of the increased limit, which was especially important for smaller governments who found it difficult to access capital markets during and following the financial crisis. The legislation would also allow the BQ amount to be applied to the ultimate borrower rather than the issuer, which is of great use to smaller healthcare and higher education entities that must use larger, statewide authorities to sell their debt.

New Transportation Bonds and Using P3s. Senate Finance Ranking Minority Member Ron Wyden (D-OR) and Sen. John Hoeven (R-ND) introduced S. 1186, the *Move America Act of 2015*. The bill would create new bonds for transportation purposes and promote the usage of public-private partnerships (P3s) to help state and local governments with their infrastructure needs. Move America bonds would allow greater flexibility in the private use rules to help governments finance publicly available transportation infrastructure, including airports, docks and wharves, mass commuting facilities, freight and passenger rail, highways and freight transfer facilities. The legislation also creates Move America Credits that would pave the way for greater private equity investment by allowing a state to sell credits to raise capital or allocate the credits to a project sponsor.

Treating Municipals as High-Quality Liquid Assets. Earlier this month, **MMA** discussed international banking liquidity regulations – Basel III – and the market issues associated with municipal securities not deemed to be high-quality liquid assets (HQLA). Rep. Luke Messer (R-IN) and 8 of his colleagues from both sides of the aisle introduced legislation (H.R. 2209) that calls on Federal banking agencies to “treat a municipal obligation that is both liquid and readily marketable (as defined in the Final Rule) and investment grade as of the calculation date as a high-quality liquid asset that is a level 2A liquid asset.”

More Transportation Funding. Committees in Congress continue to struggle with finding long-term financing options for the country’s infrastructure and highway trust fund programs. The current mechanism for funding expires at the end of this month, and it is unlikely that Congress will be able to do much before then aside from vote for another extension – the timing of which could be for a couple more months or until the end of the year. Members will continue to mull over long-term funding options, but, absent the political will necessary to attract a majority to pass a long-term funding solution, federal highway and transit programs will continue to operate in an uncertain climate and under short-term extensions.

Comprehensive Tax Reform and Municipals. Last month, 124 House members signed a bipartisan letter calling on House leaders to protect the tax-exemption for municipal bonds. The letter expressed concern with tax proposals that could diminish the ability of state and local governments to use bonds to finance projects for their communities. The letter specifically raises attention to proposals that would place a cap on the amount of interest taxpayers could deduct for their municipal investments, stating “it would increase borrowing costs to public entities and shift costs to local residents though tax and rate increases.” It is unclear whether the House will be able to seriously look at tax-reform proposals this year. House Ways and Means Chairman Paul Ryan (R-WI) has indicated that corporate – rather than individual – tax reform may be first in the reform line-up from their side of the Capitol. In the Senate, a draft of tax-reform proposals from the Senate Finance Committee is expected to emerge this month.

Other Tidbits

Sales Tax Deduction. The House passed legislation in April that would allow taxpayers to deduct their state and local sales taxes in their federal return on a permanent basis. While taxpayers have been able to deduct their income taxes, Congress has taken a piecemeal approach of allowing the sales tax deduction to occur one or two years at a time. This legislation – which is especially important to those who live in states without an income tax such as Florida and Texas – provides greater ongoing certainty to taxpayers about their deductions.

No Bailouts. Sen. David Vitter (R-LA) introduced legislation (S. 94) that would (aside from federal disaster relief) prohibit federal funds be used to bailout state and local governments that have “defaulted on its obligations, is at risk of defaulting or is likely to default, without such federal assistance.” The legislation would also stop the Federal Reserve from purchasing or guaranteeing any asset or obligation of state and local governments. This is not the first time a bill like this has been introduced in Congress. Situations in distressed cities, most recently Chicago, heighten the political implications in Washington.

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

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

- **Connecticut** has been in the market with its general obligation credit already once this year and the spreads were wider this time around. There is the perception that the state may suffer from some of the same pension issues that Illinois has faced and the deal was cheaper as a result. However, the bonds ended up trading better in secondary market right after the sale.
- **Pennsylvania** also suffers from the same perception that Connecticut does in the wake of the Chicago headlines, however the Pennsylvania **Turnpike Authority** saw decent levels for its rating and the bonds improved in secondary markets this week.
- **Arizona's Salt River District** was the largest deal last week and was able to upsize its offering through the pricing process. During re-pricing, yields had to be adjusted in both directions—a result of a difficult pricing environment.

NORTHEAST

5/12: **Siebert Brandford Shank & Co.** priced $500 million general obligation bonds for **Connecticut**; Aa3/AA/AA, Kroll: AA; callable at par in 6/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.72	+36
2025	5.00	2.75	+46
2035	5.00	3.55	+53

Notes: Big adjustments (cheaper) were needed to close account

MID-ATLANTIC

5/14: **Loop Capital Markets** priced $380 million fixed rate bonds for the **Pennsylvania Turnpike Commission**; A1/A+/A+; callable at par in 6/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2016	0.60	0.60	+38
2025	5.00	2.99	+69
2045	5.00	4.01	+75

Notes: 5% coupon structure remains popular in rate environment

MIDWEST

5/13: **Gresham, OR** sold $19.2 million full faith and credit refunding and project obligations to **Citigroup Global Markets Inc.**; Aa3/NR/NR; callable at par in 5/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	4.00	1.60	+24
2025	5.00	2.48	+19
2035	3.50	3.68	+66

Notes: Sub 5% coupon out long indicative of insurance co interest

SOUTHEAST

5/14: **Robert W. Baird & Co.** priced $24.8 million limited obligation bonds for **Pender County, NC**; Aa3/AA-/NR; callable at par in 4/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.95	+55
2025	5.00	2.84	+54
2035	3.75	4.00	+96

Notes: This is a wider spread for this credit

SOUTHWEST

5/13: **Goldman, Sachs & Co.** priced $918 million electric system revenue bonds for the **Salt River Project Agricultural Improvement and Power District, AZ**; Aa1/AA/NR; callable at par in 6/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.60	+24
2035	5.00	3.35	+33
2045	5.00	3.56	+33

Notes: Adjustments had to be made before closing account

FARWEST

5/11: **Piper Jaffray & Co.** priced $10 million general obligation bonds for the **Southern Kern USD, CA**; AGM, NR/A+/NR; callable at par in 11/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.75	+41
2025	5.00	2.81	+55
2039	5.00	3.78	+68

Notes: Note bond insurance wrap saved issuer 10-20 basis points