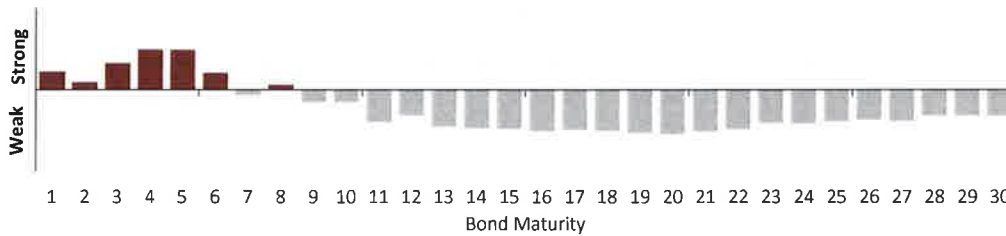
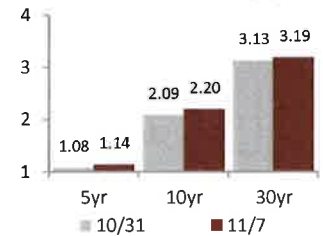


MUNICIPAL ISSUER BRIEF

Strong or Weak Market for Bond Sellers



Muni Bond Rates (%)



Heading into this week, the challenges since the middle of October in the tax-exempt space were magnified by last week's large new-issue calendar and left most of the yield curve in a weak, or more challenging, market for issuers this week. There continues to be strength in shorter maturities.

MARKET UPDATE

MUNICIPALS CONTINUE TO STRUGGLE: Interest rates for municipal issuers continued to rise last week as the large new-issue calendar forced underwriters to offer higher yields to entice investors.

INVESTORS & ISSUERS: Many deals re-priced cheaper last week

- The municipal market struggled last week as broader bond markets declined but tax-exempts found it **especially challenging** for a number of factors and saw yields rise faster than other bonds.
- The largest new-issue calendar in more than 3 months **tipped the supply/demand balance away from issuers** as the frequent, high-grade entities like New York City Transitional Finance Authority, the Los Angeles Department of Water and Power and the State Public Works Board of California struggled to gain traction.
- Multiple higher-rated competitive deals—which have generally seen strong dealer sponsorship this year—also had a more difficult time of it as several of these **deals ended up pricing cheaper than recent norms**. (See [page 4](#) for more on regional deals.)
- The secondary markets were also challenged as many **mutual funds and insurance companies sold their investments in the secondary market** that made for pressure on rates and competed for investor attention on new deals.
- Still—there was a silver lining heading into this week's smaller calendar—on Friday the monthly employment report made for a small rally in the Treasury market with which **municipals did not keep up**. This sets a positive backdrop headed into this week (See [Figure 1](#) for more on positives headed into the week).
- The SEC is increasingly focused on the municipal market as the Commission most recently charged 13 firms with breaking size rules of Puerto Rico trades (they traded less than \$100,000 in size, which was not allowed.) This is another reason **MMA** suggests that **issuers follow how their new deals trade in the secondary markets after issuing in the primary**.

MIDTERM BOND BALLOTS: About \$37 billion of the \$44 billion state and local bond proposals succeeded in last week's elections, which implies that taxpayers maybe be more supportive of new investment in public infrastructure (\$7.45B in CA alone). This figure is still on a smaller scale compared to record years (nearly \$70B in 2006) as such, the municipal industry should expect new-money issuance to remain suppressed in 2015. (For more on the midterm elections' effects on municipals, see [page 3](#).)

BUYERS BITES:

WHAT IS TRENDING HOT:

- 1) California GO
- 2) Tobacco, Puerto Rico
- 3) Step Coupon

CURRENTLY HARDER SELLS:

- 1) New York paper underperforming
- 2) Illinois GO

WHO IS REPORTEDLY BUYING:

Regional banks, hedge funds, dealer proprietary trading desks

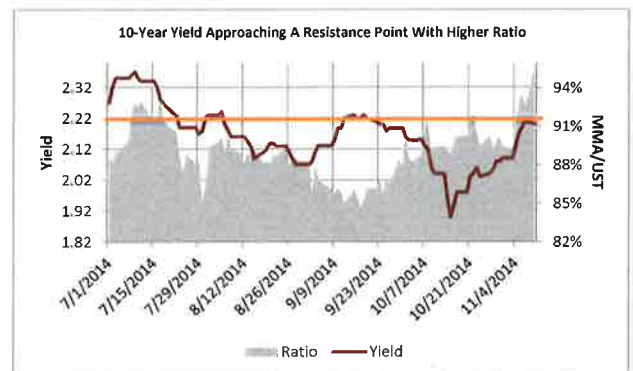


Figure 1: The chart above tracks the 10-year AAA tax-exempt yield in the maroon line with the grey shaded area the percentage of that yield as it relates to the U.S. Treasury 10-year bond (ratio). The yellow line points out the 2.20% yield level, which since the summer has proven to be a point at which investors see value in municipal bonds. Note that twice since July it was at this point where the market began to see positive momentum to lower yields. Also included is the ratio to show that the relative value of tax-exempt bonds to taxables has increased of late, contributing to the argument that the municipal market is poised to improve in the near-term. However, while relative value has increased **MMA's** municipal market's price trend remains negative as it has been since October 21—challenging investor demand.

TOPIC OF THE WEEK: GREEN BONDS

GREEN BONDS, MUNICIPAL BONDS: Green bonds are a relatively new product in the municipal market, one that many issuers are turning to as a way to portray their government’s capital spending on long-term environmentally sustainable projects. Green bonds are tax-exempt securities, typically secured by regular municipal pledges similar to the manner issuers’ other outstanding debt is paid. However, there is also opportunity to promote “green projects” in public-private-partnerships and social impact bond projects. It is important to note that the “green” signifies how proceeds are spent, not how bonds are secured or repaid. While there are no federal legal terms to define “green bonds” and “green projects,” the World Bank developed “Green Bond Principals, 2014,” which was adopted by a consortium of major investment banks in January. These principals allow governments to follow established protocols to “designate, disclose, manage, and report” on the proceeds of green bonds and ensure that bond proceeds fit into an accepted green category. The protocols also include a required regime of compliance to track project accounts separately and transparently until all proceeds are spent.

So far in 2014, the US municipal market has seen more than \$1 billion in stated green bond issuance by states and cities, by far surpassing issuance in previous years. Of course, many more municipal bonds theoretically would qualify for some form of “green treatment” if the projects promote and use up-to-date technologies for their issuance purpose.

WHAT IT MEANS FOR YOU: From a market standpoint, the green labeling has the potential positive effect of attracting existing and new non-traditional and green-oriented investors into the market. In reviewing 3 recent green deals out of California, Massachusetts, and Washington, DC, the designation appeared to moderately diversify those parties who invested in the bonds. It is important to note that several large asset managers (i.e. Black Rock and Breckenridge) have successfully launched efforts both domestically and internationally to secure investments in the green space, and may now see the US municipal marketplace as a natural landing place. This could potentially lead to a structural (meaning non-cyclical) addition to municipal demand coming from traditional (meaning non-levered, unhedged) asset managers.

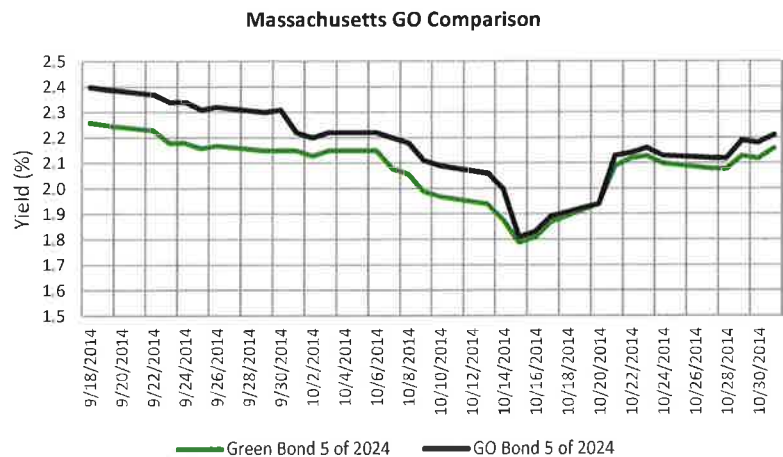


Figure 2: Following the evaluations of the latest MA GO green and non-green deal we note that the secondary market is not giving green a premium compared to non-green.

Politically, MMA views the green concept as having some bipartisan support at local, state, and federal levels of government. One example of this is the support from the Obama Administration and some bipartisan support in Congress to promote and increase the use of P3s to help address the country’s infrastructure deficit. Adding a “green” element to the growing use of P3s, is seen as a positive trend for our industry, especially as we continue to battle the misconceptions some have about state and local governments issuing tax-exempt securities. Further, there are some advocates who may push for a deeper tax subsidy for these types of projects, such as, a “green” bank-qualified provision or something similar.

While there is considerable upside to issuing “green bonds,” issuers need to keep in mind a few items:

- Investors remain alert to the issuing of “green bonds” as a substitute for otherwise PAYGO spending items by using bond proceeds as an attempt to maximize issue size, and creating potential budget sustainability issues in the long-term;
- Issuers should refrain from using the term “green bonds” and “green projects” as a marketing gimmick, and actually follow the before-mentioned protocols developed for these projects;
- Investors will be demanding superb primary and ongoing disclosure for these bonds, and significant information about how the “green projects” are being paid for with bond proceeds; and,
- While some bipartisan agreement is noted, there still remain a large portion of policymakers who do not believe in climate change and therefore their support for green projects might be muted if not outright unresponsive.

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

NORTHEAST

11/6: The **Massachusetts Water Resource Authority** sold \$141 million of general revenue refunding bonds to **Bank of America Merrill Lynch**; Aa1/AA+/AA+; callable in 8/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2024	5.00	2.43	+24
2029	5.00	2.78	+14
2039	4.00	3.65	+53

Notes: Issuer found good follow-through despite challenging market

MID-ATLANTIC

11/5: **Montgomery County, Maryland** sold \$821 million general obligation bonds to **Citigroup Global Markets Inc. and Barclays Capital**; Aaa/AAA/AAA; callable in 11/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.15	+2
2024	5.00	2.20	+1
2034	4.00	3.11	+16

Notes: These two deals came at wider spreads than recent levels

MIDWEST

11/6: **JPMorgan Securities LLC** priced \$94 million transportation revenue refunding bonds for **Wisconsin**; Aa2/AA+/AA+; Kroll: AAA; callable in 7/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.20	+7
2024	5.00	2.41	+22
2027	5.00	2.70	+21

Notes: The issuer bumped levels on the 5-year maturity

SOUTHEAST

11/5: **North Carolina** sold \$300 million limited obligation refunding bonds to **Wells Fargo Securities**; Aa1/AA+/AA+; callable in 5/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.22	+10
2024	5.00	2.32	+15
2028	3.00	3.10	+54

Notes: This high-grade deal priced amid a large competitive slate

SOUTHWEST

11/5: **Bank of America Merrill Lynch** priced \$461 million revenue refunding first tier and second tier bonds for the **North Texas Tollway Authority System**; A2/A-/NR; callable in 1/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.73	+29
2024	5.00	2.77	+60
2025	5.00	2.89	+60

Notes: Yield seekers allowed for large bumps in a re-pricing

FARWEST

11/6: **Morgan Stanley & Co.** priced \$271 million water system revenue bonds for the **Los Angeles Department of Water and Power**; Aa2/AA/AA; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.06	-6
2024	5.00	2.24	+5
2044	5.00	3.41	+23

Notes: The deal faced concessions but still priced tight to MMA 5%

ELECTION ROUNDUP

IMMEDIATE ELECTION TAKEAWAYS: 1) A Republican-controlled Congress should become less gridlocked, which raises the potential for tax-reform and/or new infrastructure legislation to make its way out of the legislative branch. Still – **MMA** puts the risk of the exemption being harmed at below 50%, as there is limited time to enact sweeping legislation with a presidential election looming. Corporate tax reform, however, appears more politically viable over comprehensive (and has less direct implications for the tax-exemption itself) and the incoming Congress has few issues to claim as “mandated” because much of this campaign season was run on an anti-Obama message. However, Democratic staff from the tax-writing committees said last week they would not support a corporate-only reform. **Takeaway:** expect headline risk to materialize with low chance of adoption.

2) Direct-pay (BABs), private-activity bonds and a national infrastructure bank are a non-starter. The Senate Republicans have drawn a line in the sand when it comes to direct-pay; Outgoing Ways & Means Chairman Dave Camp’s last reform bill reveals

the interest exclusion for the future issuance of private activity bonds. 3) Still, one of the few areas of clear bipartisan agreement is toward the need for more infrastructure financing. Public-private-partnerships are, in theory, a middle ground between the President and Republicans who have voiced support for these engagements in various different measures. **Takeaway:** How leaders approach P3s will be important to watch as strong lobbying interests in DC have been highly engaged in pushing the P3 model and there may be tangential effects on the municipal market as a result.

4) Gina Raimondo’s election in RI helped validate the state’s pension reform and likely precludes the risk of a state default on its 38 Studio bonds in the future: both strong positives for state credit quality and trading value. Bruce Rauner’s election in Illinois, by contrast, creates uncertainty over future state budget balance—Mr. Rauner has been opposed to extending personal income tax surcharges that many credit analysts assume are critical revenue inputs. (See **Buyers Bites** on **page 1**)