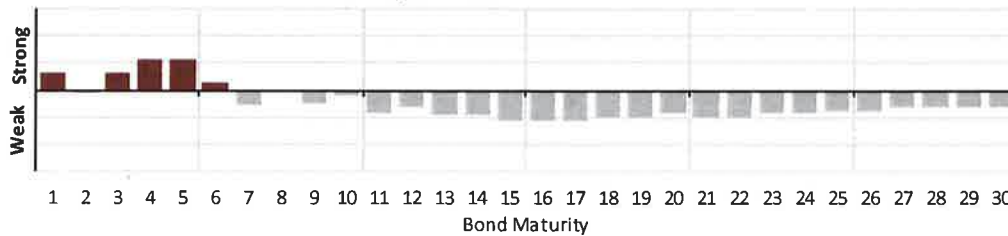
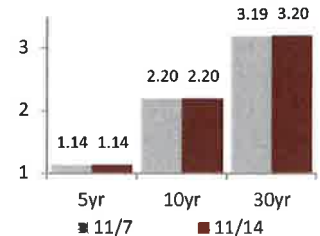


MUNICIPAL ISSUER BRIEF

Strong or Weak Market for Bond Sellers



Muni Bond Rates (%)



Heading into this week, the negative dynamic for much of the yield curve remains in tact (and has been this way for 3 straight weeks). Still, the weak bias has lessened after last week's flat performance. Shorter maturities continue to see the most interest from investors, as buyers look to keep duration short in volatile times.

MARKET UPDATE

MUNICIPALS TREAD WATER: Rate direction was inconclusive throughout the week as the market was unable to get over the hump of negative performance over the last 3 weeks. Rates were largely unchanged—perhaps a modest positive moving forward.

INVESTORS & ISSUERS: At a crossroads headed into this week

- With Veterans Day closing bond markets on Tuesday last week, the market priced roughly \$6 billion of bonds in two days, **causing a clog in the primary that resulted in generally cheaper yields to entice customer interest in the larger negotiated loans.**
- Hence, it was not a surprise for bonds from the larger Hawaii, New York City Municipal Water Finance Authority and Louisiana issues to trade **to modestly better prices in secondary markets.**
- Recently upgraded California sold via competitive auction on Thursday and received aggressive bidding by dealers to lock in strong rates for the issuer. **However, it seemed that rather large balances were left on some of the dealer's books** and, thus some GOs began to trade at modest concessions in secondary markets. (See [page 3](#) for more on regional deals.)
- While high-grade rates were generally unchanged, investor **ambivalence** still was in effect, resulting in some challenges in pricing. **This week's larger new-issue slate is apt to be difficult for issuers.**
- Still, the **MMA Price Performance Index** is edging toward positive for the first time since October 21st and this could allow for better momentum moving forward.
- We are also keeping an eye on secondary selling pressure, which continued to be elevated last week **as several larger mutual funds and insurance companies sold from their municipal portfolios.**

BUYERS BITES:

WHAT IS TRENDING HOT:

- 1) The flip on recent large negotiated deals
- 2) State GOs

CURRENTLY HARDER SELLS:

- 1) 4% coupon or lower underperforming
- 2) California COPs

WHO IS REPORTEDLY BUYING:

Regional banks, SMAs, dealer proprietary trading desks

ICI Muni Mutual Fund Net Inflows in 2014 (\$B)

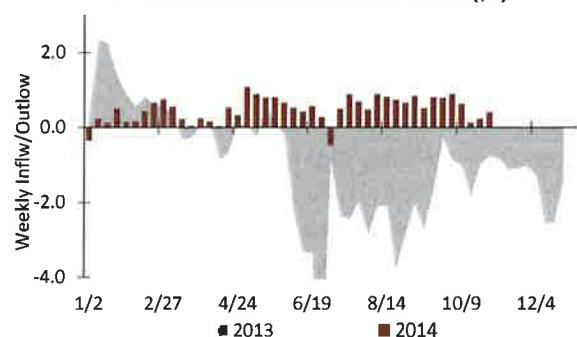


Figure 1: The chart above tracks week-by-week cash going into and out of mutual funds that purchase municipal bonds. The maroon columns reflect each week of 2014 with the grey shaded area tracking last year's week-to-week changes. Part of this year's strong municipal performance has been attributed to mutual funds consistent role as municipal purchasers. Last year, the outflows caused major problems for the entire market. As noted in this week's bullets, some mutual funds are seeing outflows and selling in the secondary markets. If this continues it could cause broader market challenges—issuers can track the data weekly via data from the Investment Company Institute (ICI).

BANKRUPTCY IMPLICATIONS: In a report last week, **Standard & Poor's** said it will not make changes to the way it assigns ratings to limited- and unlimited-tax GO pledges in the U.S. public finance sector following the Detroit and Stockton bankruptcies. **S&P said it did not believe a precedent was set** that would be widely applicable to GO debt (as the Detroit and Stockton bankruptcies represent too small of a sample size to justify widespread rating changes). **Topic of the Week** addresses **MMA's** different perspective than S&P on the subject on the **next page.**

TOPIC OF THE WEEK: DETROIT

DETROIT IS ALL NEGATIVE: Detroit, Michigan officially exited Chapter 9 protection—ending the largest U.S. municipal bankruptcy in history. The Plan of Adjustment (POA) accepted by the bankruptcy judge has a variety of conclusions that are uniformly negative for the industry and for issuers in particular.

There is one important premise in which **MMA** differs from other market participants. Some have argued that because the POA represents a series of settlements between the various entities and does not set legal precedent; therefore the city is not a model for other issuers if those issuers enter bankruptcy protection. **MMA** disagrees: this POA represents a *perceived* precedent for future bankruptcies and while having no technical legal power over future Chapter 9 negotiations, any careful manager of risk must assume that this is the now the standard for how creditors are treated.

The big takeaways:

- Pensioners received better treatment than bondholders (pension payments will continue to receive payments while pension obligation bonds get less than 10 cents on the dollar)
- Other post-employment benefit contracts are also better positioned than bondholders—a major deviation in thinking as it was widely believed that these contracts could be abridged (OPEBs mostly funded while unsecured GO bond holders getting 17 cents on the dollar)
- Investors in the secured bonds (mostly the Detroit Water and Sewer bondholders) were also impaired as they accepted a sub-par tender
- Investors capitulated—in nearly every arrangement, investors were strongly persuaded into accepting less, setting dangerous expectations going forward for other cities considering a bankruptcy path. As **MMA** wrote to our institutional clients last week: a security not defended, is no security at all.
- The city did not address its revenue problem and only focused on minimizing its liabilities. This, along with Detroit's defaulted GO on the books, means the city is unlikely to be able to borrow in the near-term. **MMA** believes that barring a major population boost in the city that it could re-enter bankruptcy in the next 5-years because of this
- **Foes of the tax-exempt nature of municipal bonds have a new narrative to paint Detroit's sins over all states and localities.**

WHAT IT MEANS FOR YOU: All else being equal, over the longer term this implies higher borrowing costs for issuers. Note that on the other side of the country in Stockton, CA a different judge also put pensioners in senior positions to bond investors, adding credence to the argument that while no legal precedent has been set, any careful manager of risk must assume investors will be subordinate to other entities in the case of a bankruptcy. Therefore, investors are likely to charge issuers more to lend capital. The 2014 rally has reduced the penalty Detroit and other Michigan cities faced in the wake of the bankruptcy. A rising-interest-rate environment could prompt more investor selectivity. Franklin Advisors, a large fund complex, has stated it will not purchase any California cities certificates of participation in the wake of the Stockton decision—this type of market discipline could increase if there are more cities follow Stockton's model. Lower-rated cities could face the largest market penalty, as in theory, they would be closer to entering a bankruptcy situation. In contrast, investment grade credits are apt to see little, if no market impact.

PUBLIC PENSIONS

PENSIONS IN FOCUS: **MMA** believes that pension funding has become a key credit factor when investors analyze municipal bond issuers (as discussed in 10/20 [MIB](#)). While the financial health of pensions is increasingly a differentiating factor in the credit quality of states, underfunding has generally not been a threat to the payment of state-issued bonds. However, pension, and surprisingly OPEB obligations, have jeopardized the repayment of capital market creditors for distressed local governments, especially those with access to Chapter 9 bankruptcy protection, as we discussed above with Detroit.

At a Penn Institute for Urban Research event earlier this month, numerous industry experts presented on the state of public pensions and how best to address underfunding in this area. Panelists at the [forum](#), Urban Fiscal Stability and Public Pensions: Sustainability Going Forward, said solutions are needed to help address state and local government pension liabilities. The need

for increased transparency of pension liabilities as well as a government's outstanding debt portfolio were discussed as part of a solution, and **MMA's** Matt Fabian, said the industry needs to accept long-term, diverse ideas to account for the differences between governments. At the same panel, former New York Lieutenant Governor Richard Ravitch took a more aggressive approach and said the federal government lacks awareness of state and local governments' pensions woes, and debt and general budget issues. Ravitch, who also is [Co-Chair](#) of the State Budget Crisis Task Force, further commented that the federal government should look to overturn the Tower Amendment and allow the SEC to regulate state and local governments that issue debt.

Pensions will likely remain a hot topic among policymakers and issuers should take note, as investor sensitivity has increased.

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

NORTHEAST

11/13: **Bank of America Merrill Lynch** priced \$764M transportation program bonds for the **NJ Transportation Trust Fund Authority**; A2/NR/A-; callable in 6/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.96	+82
2024	5.00	3.29	+109
2044	5.00	4.32	+113

Notes: The issuer found support on the short end of the yield curve

MID-ATLANTIC

11/13: **Piper Jaffray & Co.** priced \$4.38M general obligation bonds for the **Borough of Coraopolis, Allegheny County, PA**; NR/A+/NR; Assured Guaranty Municipal Corp insured; callable in 11/1/2019:

Maturity	Coupon	Yield	+/- AAA 5%
2019	2.00	1.60	+46
2024	2.625	2.75	+55
2044	4.00	4.13	+94

Notes: Insurance, a short call & BQ status benefited the issuer

MIDWEST

11/13: **Stifel Nicolaus & Company Inc.** priced \$68M revenue refunding and improvement bonds for **Hamilton County, Ohio Convention Center Facilities Authority**; A2/A/NR; callable in 12/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.66	+51
2024	5.00	2.87	+64
2033	5.00	3.60	+58

Notes: The 9-year call pushed prices higher

SOUTHEAST

11/13: **Bank of America Merrill Lynch** priced \$205M Northeast Georgia Health System revenue anticipation certificates for **Hospital Authority of Hall County & the City of Gainesville**; NR/AA-/AA-; callable in 2/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2046	4.00	4.18	NA
2049	5.25	3.95	NA
2054	5.50	4.02	NA

Notes: Health care demand helped the issuer lower yields

SOUTHWEST

11/12: **Morgan Stanley & Co.** priced \$250M revenue financing system refunding bonds for the **Board of Regents of the University of Texas System**; Aaa/AAA/AAA; callable in 8/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.13	-1
2024	5.00	2.27	+7
2037	4.00	3.46	+41

Notes: Mixed market had this triple-A issuer re-priced cheaper

FARWEST

11/13: **JPMorgan Securities LLC** priced \$785M general obligation bonds for the **State of Hawaii**; Aa2/AA/AA; callable in 8/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.21	+7
2024	5.00	2.41	+21
2034	5.00	3.08	+14

Notes: The largest negotiated deal of the week offered concessions