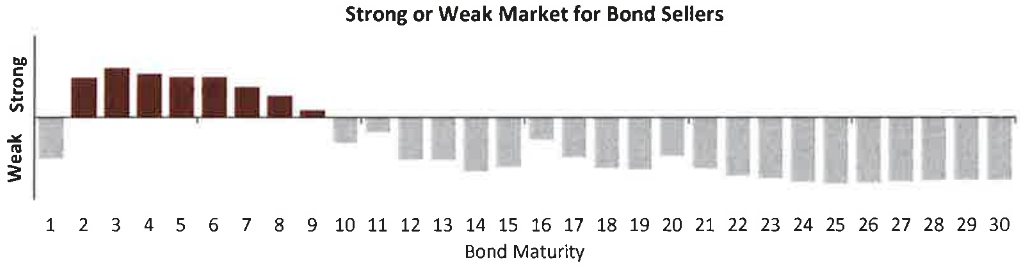
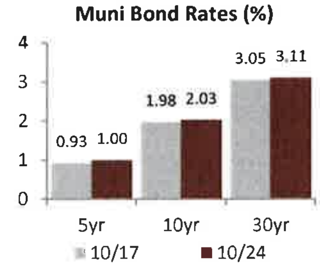
MMA The Power of Independence

OCTOBER 27, 2014

MUNICIPAL ISSUER BRIEF





Heading into this week, the poor performance of last week made for a difficult pricing environment for bonds maturing 10-years and longer, while shorter maturities showed strength as investors exhibited a more defensive posture and focused their buying on the front of the curve.

MARKET UPDATE

MUNICIPALS SEE FIRST WEEKLY LOSSES IN MORE THAN A MONTH: Many issuers struggled to obtain low rates as the broader context for fixed-income was challenging. Municipal bond market difficulties were accentuated with a few fundamental hurdles.

INVESTORS & ISSUERS: Challenges last week now offer opportunity

- The municipal market was weaker each day last week except for Friday **as tax-exempts were pushed into modestly higher yield ranges by losses in other bond markets.**
- **The secondary market was tested** by an increase in secondary selling pressure as several mutual funds and hedge funds sold their municipal investments (see ***Figure 1***).
- This difficult secondary market negatively affected several new issues. Early in the week, the influential and triple-A state of Delaware was **forced to cheapen yields as much as 20 basis points to secure investors.** The New York Metropolitan Transportation Authority found few retail investors on Wednesday, and also cheapened yields on Thursday before the account closed.
- As has been the case through much of the year, the higher-rated competitive issues saw fairly strong bidding by dealers and lower-rated issuers saw bigger demand. **Lower-rated issuers have benefitted from non-traditional investors that normally purchase corporate debt but see opportunity in higher-yielding municipal deals.**
- This sets the stage up well for this week's very large non-rated issue that will help finance the new World Trade Center project in New York City.
- Most important—going forward MMA is constructive on the tax-exempt market headed into year-end: the losses last week paused on Friday and support was evident from selective buyers. Secondary selling pressure eased and "customer-purchases" increased to nearly 2-times the 3-month average on Friday—**a very good sign for near-term issuers.**

SEC'S JOHN CROSS RETURNS TO TREASURY: The Securities and Exchange Commission (SEC) Office of Municipal Securities is losing its leader as John Cross heads back the Office of Tax Policy at the Treasury Department. The SEC has not announced a replacement for Cross, who has headed the Department and overseen the SEC's Municipal Advisor Rule writing and implementation since 2012. The position was created in response to the financial crisis.

BUYERS BITES:

WHAT IS TRENDING HOT:

1) Lower-rated transportation, casino revenues
2) Lower IG Airport bonds

CURRENTLY HARDER SELLS:

1) New York retail
2) Longer maturities led losses last week
3) High-grade GO negotiated sales

WHO IS REPORTEDLY BUYING:

Large and regional banks, hedge funds, dealer proprietary trading desks

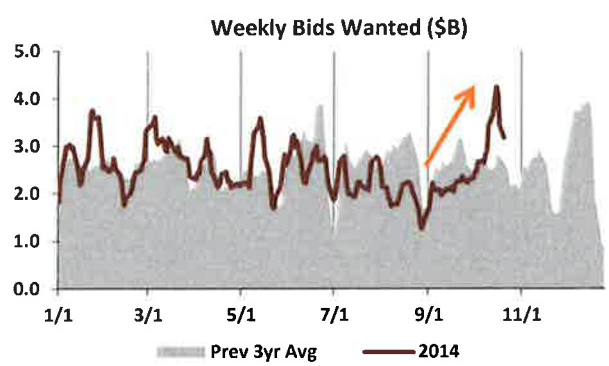
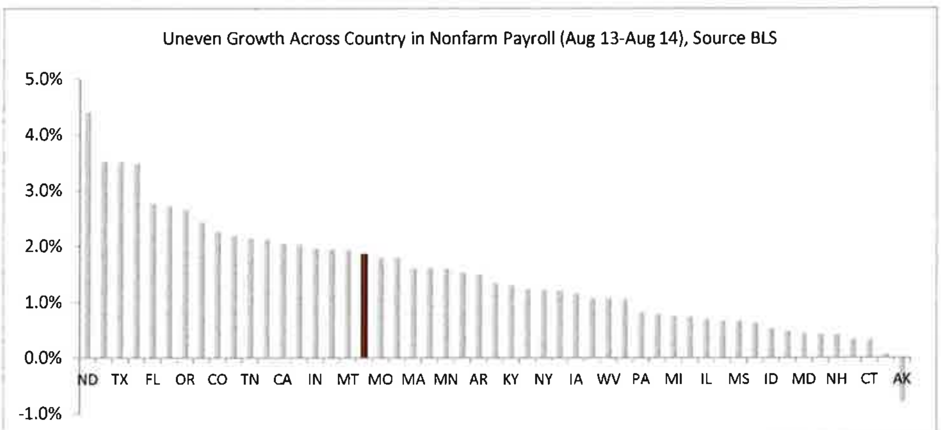


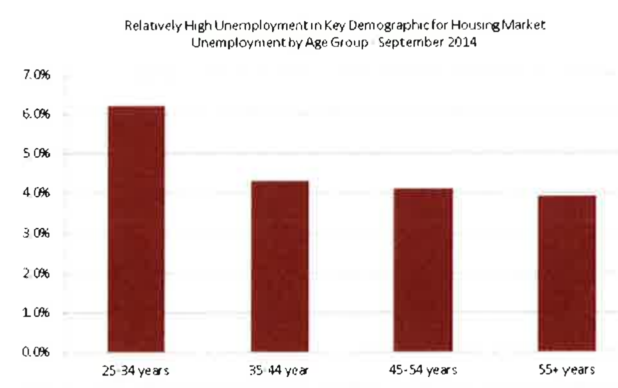
***Figure 1**: The chart above tracks the amount of bids-wanted (bond sellers) par posted in the secondary market for municipal bonds. The red line tracks this year's weekly total while the grey shaded area is the average volume over the past 3 years. The arrow points out the increase in secondary selling pressure that has occurred over the last 8 or 9 trading sessions, hitting a peak on Wednesday of last week. Historically, when selling pressure has increased, the market has been less focused on primary offerings. Heavier secondary selling can create a disorderly market place and thus can negatively influence yield direction. Conversely, on Thursday and Friday, of last week, secondary selling ebbed and suggested a constructive context was forming to issuers' benefit for deals priced this week.*

TOPIC OF THE WEEK: JOBS, HOUSING & LOCAL GOVERNMENTS

JOBS AND HOUSING, HAND IN HAND: When assessing a state or city's fiscal health municipal bond investors are increasingly looking at job creation as an important indicator of credit health. Job creation is critical to the growth of state revenues, as it can forecast future levels of personal income and sales taxes. It is also a key influence in the health of a region's housing market, which affects property taxes—the primary source of revenues for local governments. Less fiscally robust local governments in states with weaker job growth are more likely to experience investors' wariness of an issuers' credit stress, as expenditure growth (particularly employee-related costs) outpaces gains in available resources. **Since 2010, the correlation between job growth and home price appreciation has proven to be strong among the highest issuance states. States with weaker job growth are likely to show smaller gains in house price appreciation, constraining property tax revenues in the communities affected.** Several states with less vigorous housing markets have constraints on raising these taxes, which limits a municipality's flexibility to adjust its key revenue source as needed. State aid, another local government revenue source, may also be less generous if soft job growth affects the state's own personal income tax and sales tax revenues. As an example, New Jersey, Virginia and Maryland have been among the states posting the weakest gains in non-farm payrolls, 0.1%, 0.4% and 0.5%, respectively, compared with US gains 1.9%. All three states have announced revenue shortfalls owing in part to the jobs situation. Most recently, Maryland lowered its revenue projections by $405 million ($177 million for the current fiscal year and $228 million for the next year).



WHAT IT MEANS FOR YOU: MMA expects investors to track this data more closely going forward and it may affect your borrowing costs as a result. **The good news:** revenue gains should be more sustainable in the broad context and going forward. Today's housing market advances are likely to be much more durable than the rapid increases experienced during the housing boom. At that time, subprime lending—particularly in weaker labor markets—drove growth that was unsustainable because it was not supported by gains in income. A paper by Mian and Sufi published in the Quarterly Journal of Economics in 2009 found that the period from 2002 to 2005 was the only time since around 1990 that income and mortgage credit growth were negatively correlated. It is unlikely dramatic declines in home values—and the related impact on property tax revenues—are likely to occur in the foreseeable future. **However, some negative trends have arisen.** Home buying is on the decline, especially in the key 25- to 34-year-old group, which has had a strong negative effect on the housing market. Since 2004, the percentage of homeowners from that segment of the population has fallen from 43.6% to 36.2%. And as of March 2014 homeownership is only 13.2% among those younger than 35, down 0.4% from the end of 2013 and down 4.0% since 2005. High student loan debt—averaging about $30,000—and an elevated unemployment rate for the age group has become a drag on the overall housing market. This means that investors in local government debt in states that have relatively weak job growth will take a closer look at housing trends in the local area to see whether growth is slowing. If stagnant or slowing growth is found, investors may consider the potential effect housing conditions may have on local government revenues against expected expenditure growth and identify whether future fiscal strains could be on the horizon. On the other hand, gains in housing would generally be seen as an improving economic landscape. Issuers should monitor home values and job growth in their states as a gauge of how different market participants may analyze the creditworthiness of their bonds.



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

NORTHEAST

10/22: **RBC Capital Markets** priced $500 million of transportation revenue bonds for the **Metropolitan Transportation Authority, New York**; A2/AA-/A; callable in 3/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2026	5.00	2.73	+48
2029	5.00	2.95	+40
2044	5.00	3.55	+44

Notes: Struggled with retail and institutions; cheapened as a result

MID-ATLANTIC

10/21: **JPMorgan Securities LLC** priced $306 million general obligation bonds for **Delaware**; Aaa/AAA/AAA; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.03	+8
2024	5.00	2.00	+2
2034	3.50	3.07	+21

Notes: Triple-A and influential, deal revealed market's weakness

MIDWEST

10/22: **JPMorgan Securities LLC** priced $300 million Detroit Regional Convention Facility Authority local project bonds for the **Michigan Finance Authority;** NR/AA-/A+; callable in 10/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.50	+51
2024	5.00	2.73	+70
2039	5.00	3.64	+58

Notes: The association with Detroit did not deter investors

SOUTHEAST

10/21: **Raymond James & Associates** priced $8 million Laurel School District general bonds for **Laurel, Mississippi**; A1/NR/NR; callable in 4/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2025	3.50	2.30	+21
2027	4.00	2.47	+17
2028	4.00	2.55	+13

Notes: This bank-qualified deal faced pressure in re-pricing

SOUTHWEST

10/22: **BOSC Inc** priced $11.6 million unlimited tax general obligation bonds for the **Lubbock Independent School District, Texas**; Aa1/AA/NR; PSF guaranteed (Aaa/AAA/NR) callable in 2/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.05	+6
2029	4.00	2.83	+28
2044	5.00	3.20	+9

Notes: Again, Texas school districts are pricing well in this climate

FARWEST

10/22: **Seattle Municipal Light & Power** sold $259 million revenue bonds to **Wells Fargo Securities**; Aa2/AA/NR; callable in 9/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.22	+23
2024	5.00	2.24	+21
2044	4.00	3.60	+49

Notes: Competitive deals continue to do well in this environment