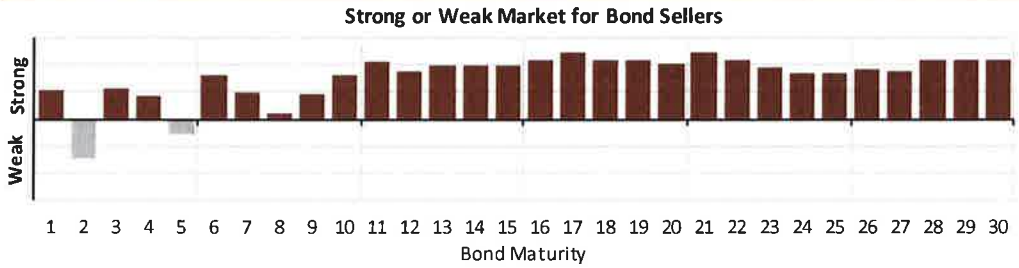
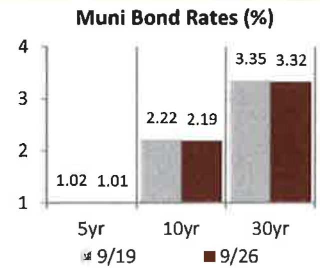
MMA The Power of Independence

SEPTEMBER 29, 2014

MUNICIPAL ISSUER BRIEF





Heading into this week, nearly the entire yield curve has a strong pricing dynamic after weeks of a more mixed tone. This has largely been a result of limited issuance this week as well as efforts among investors to ensure quarter-end strength.

MARKET UPDATE

MARKET IMPROVES FOR SECOND WEEK: The poor start to September is fully in the rear-view mirror as tax-exempts improved every single day last week. This week's issuance amount drops to the low summer average providing a strong back-drop.

INVESTORS & ISSUERS: Most new issues thriving in current market

- The municipal market moved into lower yields last week as investors put their money in safe assets on tense international headlines. This, along with **large investor interest in many of the new deals, made for a good week for many.**
- The billion-plus deals out of California and New York were the focus for many institutions–and each **saw very large retail interest** (both had nearly $1 billion in orders from individuals and SMAs), that then saw multi-billions in orders from professional managers. (See **page 3** for more on regional deals.)
- Success in the primary occurred in a variety of regions and sectors as Missouri, Arizona and San Antonio utilities, a Texas non-rated insurance-related security and the Ohio State University **all were able to lower yields in re-pricing.**
- Many of these new-deals went on to trade at better levels in the secondary markets, which helped to lower the broader interest-rate environment for all tax-exempts. **This was especially notable for New York issuers that an increase in activity** after the state's deal began to trade better in secondary markets. The same was true for California.
- Meantime, New Jersey and Pennsylvania GOs were able to improve, but **underperformed the rest of the market as a result of a series of downgrades this month** (hence Harder Sells in this week's **Buyers Bites**).
- In the middle of this week the 3rd quarter will end. Historically, **quarter end is a strong time for municipals** so this bodes well for the week's calendar of new deals.
- High-yield corporate bonds cheapened last week– but **lower-rated municipals have appeared immune to the taxable stress.**

S&P TO DISCUSS ITS RATINGS CHANGES IN WEBINAR: On October 7, **Standard and Poor's** will host a webcast to discuss the one-year implementation anniversary of its U.S. Local Governments General Obligation Ratings: Methodology and Assumptions. The free webinar will include time for questions and answers and will discuss how many ratings changed and the reasons behind the changes, and the ratings distribution of its portfolio. Register here.

BUYERS BITES:

WHAT IS TRENDING HOT:

1) Maturities 15-years and longer
2) New York, California GO
3) Texas bank-qualified

CURRENTLY HARDER SELLS:

1) New Jersey GO/appropriation-backed
2) Pennsylvania GO

WHO IS REPORTEDLY BUYING:

Individuals, property and casualty insurance companies, separately managed accounts (SMAs)

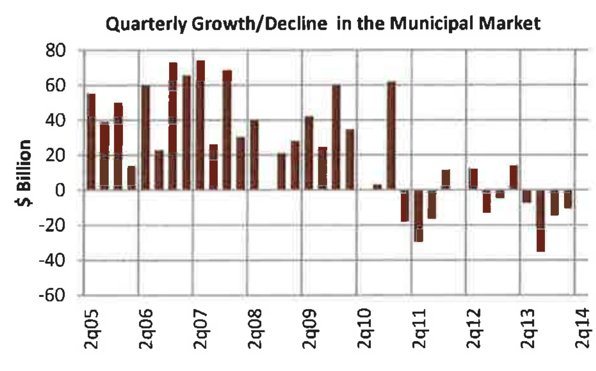


***Figure 1**: The size of the municipal market remained generally the same in the latest data from the Federal Reserve that reflects changes through the first half of 2014. Above we track the quarterly changes in the amount of outstanding debt back to 2005. In recent years the size of the market has declined as issuance has waned and bonds have come to maturity. This continues to keep the supply/demand balance in favor of issuers coming to market. We review the rest of the Fed data and what it means for issuers on **page 2** in Topic of the Week.*

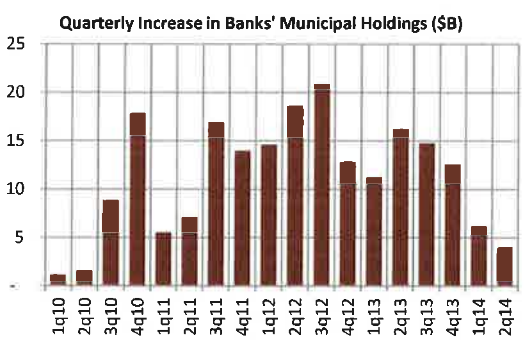
TOPIC OF THE WEEK: BOND BUYERS

BOND BUYERS: The latest data from the **Federal Reserve** offered mixed messages as some trends that began last year continued while others were reversed (**table below for details**):

- Perhaps most important for issuers, the size of the entire market remained generally the same (**Figure 1**, **Page 1**) after years of growth;
- Household investors continued to give way to institutional managers;
- Mutual funds again gained investors after massive losses in 2013 (and money market funds have a smaller role);
- Banks continued to purchase municipal bonds, but have done so at the slowest rate since the start of 2010 (**below**); and
- International buyers and insurance companies modestly increased their municipal investments.

WHAT THIS MEANS FOR YOU: An issuer coming to market should consider the changing investor dynamics of the marketplace and make sure their underwriter and municipal advisor does as well—so that a deal can be structured for the strongest investor group. Overall, after a decade of more issuance and growth in the market, the last few years has been much more mixed. As a result in the near-term, this means that issuers will continue to benefit from a favorable supply/demand imbalance that heavily favors sellers. For the longer-term it means that important infrastructure is not being developed or maintained. This is in part because of a difficult political climate in which to borrow that is magnified with an increased focus on pension costs and a slow recovery pace of the US economy.

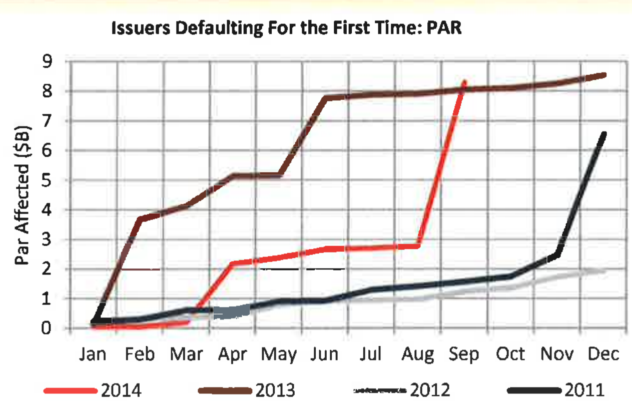
Also, **individual investors** have shifted into more professionally managed investment accounts (separately managed accounts, SMAs). Similarly, **mutual funds** have returned as a more positive vector for issuers, as assets continue to grow and cash has to be invested into municipal bonds. Most underwriters and municipal advisors can track which types of municipal funds are attracting assets (and which are not), information that can be used to directly market your securities to the funds that specialize in your credit-type or structure. **Banks** are slowing their investments into municipal bonds. This could present a challenge for large, high-grade issuers in which the bigger banks have tended to invest. Recent regulations could impede banks involvement, but **MMA** sees this as only a modest negative (read more here). Finally, international buyers and insurance companies look at municipal bonds as part of their total rate of return strategies and thus tend to compare municipals on a taxable equivalent basis to other fixed-income alternatives. Tracking world bond markets is important and can affect whether or not international or insurance companies will participate in your deal. Our webinar three weeks ago discussed this theme at length (listen to replay here).



Federal Reserve Flow of Funds Report on Municipal Bond Ownership			
2Q14	Outstanding $B's		Change
Investor Sector	Total $B's	% Market	% Qtr
Households	$1,602	43.8%	-0.4%
Mutual Funds	$642	17.5%	2.0%
Banks	$433	11.8%	0.9%
Prop/Cas. Ins.	$326	8.9%	0.0%
Money Funds	$281	7.7%	-5.1%
Life Insurers	$147	4.0%	2.0%
Closed End Fds	$86	2.3%	0.7%
Foreign Buyers	$77	2.1%	0.7%
Broker Dealers	$18	0.5%	7.7%
GSEs and Gov'ts	$12	0.3%	-3.9%
Non-Fin. Cos.	$10	0.3%	-1.9%

MUNICIPAL DEFAULT AND CREDIT IMPAIRMENT TRENDS

NEW DEFAULTS AND IMPAIRMENTS: This year has seen municipal default and impairment activity accelerate. In each of the last six months, the number of first-time defaulters has equaled or exceeded 2013 and, with Detroit's sub-par tender, the amount of par affected by payment defaults in 2014 is very likely to be the highest since **MMA** began collecting default data in 2009 (see **chart to the right**). This has the potential to generate negative headlines that issuers may have to contend with. Importantly, we point out that most issuers in the database are "risky" sector issuers. Just less than half of all current, uncured payment defaults are connected to land-secured issuers. Issuers should be vigilant in their discussions with investors to differentiate themselves from the bad apples.



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

NORTHEAST

9/23: **JPMorgan Securities LLC** priced $2.035 billion of sales tax asset revenue bonds for the **Sales Tax Asset Receivable Corporation, New York**; Aa1/AAA/AA+; callable in 10/15/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.24	+22
2024	5.00	2.32	+11
2029	5.00	2.73	-3

Notes: Issuer did well with retail investors, seeing big 10yr demand

MID-ATLANTIC

9/23: **Bank of America Merrill Lynch** priced $60 million Loyola University revenue bonds for the **Maryland Health and Higher Education Facilities Authority**; A2/A/NR; callable in 10/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2029	3.25	3.34	+58
2034	3.50	3.63	+53
2039	4.00	3.80	+52

Notes: Higher education bonds have done very well this year

MIDWEST

9/23: **BMO Capital Markets GKST, Inc.** priced $157 million of Iatan 2 Power Project revenue refunding bonds for the **Missouri Joint Municipal Electric Utility Commission**; A2/NR/A; callable in 1/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	4.00	1.20	+18
2024	5.00	2.62	+41
2034	5.00	3.38	+28

Notes: This was one of three larger utilities pricing last week

SOUTHEAST

9/24: **Bank of America Merrill Lynch** priced $100 million of water and sewer refunding revenue bonds for **Pasco County, Florida**; Aa2/AA+/AA; callable in 10/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.30	+29
2024	5.00	2.46	+26
2034	4.00	3.49	+41

Notes: Florida's lack of income tax increases cost of issuance

SOUTHEAST

9/22: The **Rio Rancho Public SD #94, New Mexico** sold $21 million of unlimited tax general obligation bonds to **FTN Financial Capital Markets**; Aa3/NR/NR; state aid withholding (Aa1); callable in 8/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2019	1.50	1.30	+28
2024	3.00	2.46	+26
2026	2.50	2.65	+21

Notes: Bank-eligible and coming competitive locked in low coupons

FARWEST

9/23: **Wells Fargo Securities** priced $2.094 billion of various purpose general obligation, refunding and put bonds for **California**; Aa3/A/A; callable in 10/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.28	+26
2024	5.00	2.48	+27
2044	5.00	3.49	+15

Notes: State took advantage of retail with three-day order period