



February 7, 2015

- Municipal Volume Growth Fueled by Refundings
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## Municipal Volume Growth Fueled by Refundings

New issuance of municipal bonds continued to increase in January to \$27.08 billion; a 38.7% rise from January 2014. This year-over-year growth was greatly influenced by a surge in refundings which tripled January 2014's total, ending January at \$15.39 billion. In the period between December 2013 and December 2014, rates for the 30-year and 10-year dropped by 133 and 73 basis points, respectively, attracting borrowers to refund their outstanding debt at much lower rates. This positive trend in refundings made up for the lack of new money issues. In January 2015 new issuance decreased by 28.3% compared to 2014, down from \$11.72 billion in 2014 to \$8.40 billion in January 2015.

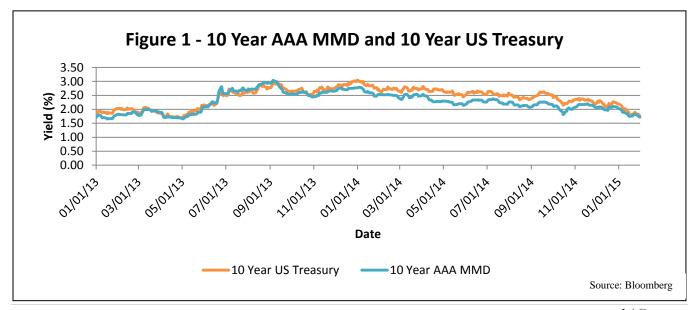
The Municipal Market Data ("MMD") 'AAA' Muni Market 10 year yield ended January at 1.72%, a 34 basis point decrease from the end of December. The 30 year yield also decreased, ending January at 2.50%, a 33 basis point drop from the end of December.

The 10-year US Treasury yield ended January at 1.68%, down

52 bps from 2.20% at the end of January. The 30-year Treasury yield also continued to decrease, dropping from 2.76% at the end of December, to 2.25% to end January. As of January 30th, the ratios of 'AAA' General Obligation municipal yields to Treasury yields were:

Year	Yield	% Yield		
1-Year	0.14 / 0.18	77.78%		
5-Year	0.94 / 1.18	79.66%		
10-Year	1.72 / 1.68	102.38%		
30-Year	2.5 / 2.25	111.11%		

Sources: The Bond Buyer, Bloomberg, US Department of Treasury, US Federal Reserve



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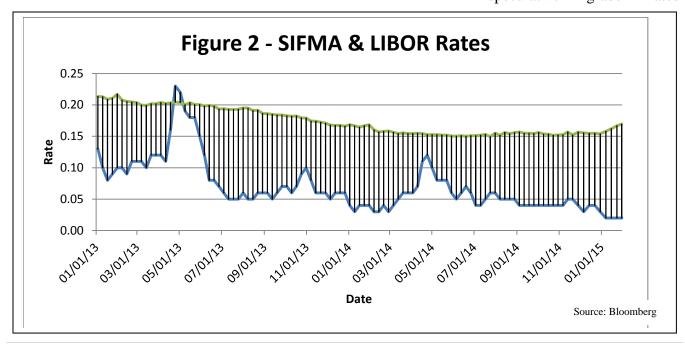
## Variable Rate Market Update

The SIFMA Municipal Swap Index, an average of high-grade, tax-exempt, variable rate bonds, ended January at .02%, down slightly from the .03% level seen at the end of November. The 30-day LIBOR increased in January, beginning the month at .1675% and ending at .17125%. Please refer to Figure 2 below for historical SIFMA and LIBOR rates.

## 2015 At a Glance Initial Default Rates S&P reported that the default rate for bonds in their

Municipal Bond Index increased slightly in 2014 after two consecutive years of decline coming out of the recession. This is according to the rating agency's Municipal Bond Index which 79,000 bonds varying credit quality from 22,000 different issuers with a market value of over \$1.5 trillion. In 2014 the index tallied a default rate of 0.17%; or in other words, 35 of the 20,568 deals in the index had a principal or interest default. Although still a very small number, this actually represents a slight jump in percentage terms from 0.11% in 2013 as six private activity bonds issued by The Energy Future Holdings Corporation (formerly TXU) experienced default. Without those six issues, the default rate would have been 0.14%.

Regardless, municipal bonds are still much safer than corporate bonds. S&P calculated a default rate of 1.52% among S&P speculative grade rated



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corporate bonds in 2014, a full 9 times larger than the rate for all the bonds in S&P's muni bond index. That was actually comparatively good performance the for corporates. In 2012, the default rate on noninvestment grade corporate bonds was more than 17 times higher than that for municipal bonds, so even through what seems like unprecedentedly dangerous times for muni bonds, they are still among the safest fixed income investments in the world by orders magnitude.

## **Shrinking VRDO's**

We've mentioned the lack of new issuance of fixed rate municipal bonds in monthly update more than a few times in the last year or so and that has certainly shown up in the overall amount outstanding. As a result of the amount of maturing debt exceeding the amount of new money, there was \$3.63 trillion of fixed rate muni bonds outstanding as of the end of the 3<sup>rd</sup> quarter of 2014, about 3.7%

lower than the market's peak vear 2010. That's certainly significant a decline, given improvement and expansion in the economy over the last four years. However, a more dramatic decline has occurred in the variable muni bond market. Variable-rate bonds, which have interest rates that reset occasionally to reflect changing conditions, have never accounted for as large a proportion of the municipal bond market as fixed rate bonds due to the constant uncertainty of possible interest rate increases. Back in 2010 when the fixed rate market hit its peak at \$3,772 billion the Variable Rate Demand Obligation market \$420 reached nobody's definition of chump change but still only 11% of the fixed rate market. Whereas the fixed

whereas the fixed rate market has declined ever so slightly since that year, the VRDO market has declined to \$203 billion, a 51.5% drop. This was not unexpected as rates have been at such a low level compared to historical norms for so long that almost everyone is sure that rates

have only way to go — up. Although a future increase in interest rates is still probable, it's interesting to contemplate just how much money those that stuck with their variable bonds have been able to save in interest costs even though rate increases were coming "soon". Even now after the Federal Reserve Board has acknowledged that rates will have to rise there is still some question as to the timing.

None of this is to imply that any issuers have chosen the correct financing method and have others chosen incorrectly because there really is no such thing. does perhaps demonstrate that like those who will be on the other side of a proposed transaction, the investors, a little diversification goes a long way. Much like smaller investors, smaller issuers may find that diversified funding sources are not a cost effective way to lower overall borrowing costs, but for larger issuers it should get strong consideration.

Sources: Standard & Poor's; SIFMA

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		Janua	ry 2015 Selected Bond	Issues						
General Obligation and Essential Service Revenue										
<u>Date</u>	Par (\$ mil)	<u>Issuer</u>	<u>Project</u>	Ratings	<u>Final</u> <u>Maturity</u>	Yield	Spread to MMD	<u>Notes</u>		
1/6/2015	\$7.34	Chesterfield Missouri	General Obligation Refunding Bonds	Aaa//	2/15/2019	1.100%	7	Fed BQ		
1/7/2015	\$44.03	Berks County, PA	General Obligation Refunding Bonds	Aa1//	11/15/2028	3.120%	97			
1/1/2015	\$9.60	Friendswood, TX	General Obligation Bonds	/AA+/	3/1/2030	2.700%	35	Fed BQ		
1/8/2015	\$29.63	Henry County, GA	General Obligation Bonds	Aa1//	5/1/2020	1.440%	18			
<b>Education S</b>	ector									
<u>Date</u>	Par <u>(\$ mil)</u>	<u>Issuer</u>	<u>Project</u>	Ratings	<u>Final</u> <u>Maturity</u>	<u>Yield</u>	Spread to MMD	<u>Notes</u>		
1/1/2015	\$16.50	Iowa State University of Science and Technology	University and College Impts	Aa2//	11/1/2034	3.380%	78			
1/15/2015	\$11.30	Indiana County, PA IDA - Student Cooperation Association	College Impts Current Refunding	/AA/	11/1/2029	3.470%	135	BAM Insured		
1/29/2015	\$6.00	Crowder College Facilities Corporation, MO	University and College Impts	/A/	8/1/2030	3.200%	99	Fed BQ		
1/28/2015	\$35.34	New Jersey State Educational Facilities Authority	Revenue Refunding Bonds	A2/AA/	7/1/2045	3.190%	65	AGM Insured		
Water/Utilit	y Sector									
<u>Date</u>	Par <u>(\$ mil)</u>	<u>Issuer</u>	<b>Project</b>	Ratings	<u>Final</u> <u>Maturity</u>	<u>Yield</u>	Spread to MMD	<u>Notes</u>		
1/7/2015	\$13.74	Plainfield Water & Sewer System, IL	Revenue Refunding Bonds	Aa2/AA/	5/1/2034	3.663%	125	State Taxable		
1/1/2015	\$16.86	Brazos Water Authority	Revenue Refunding Bonds	/AA/	2/15/2035	3.290%	69			
1/28/2015	\$6.75	Sausalito CA Financing Authority	Sewer Revenue Bonds	/AA-/	8/1/2044	3.500%	96	Fed BQ		
1/27/2015	\$9.50	Coweta County GA Water & Sewer Authority	Revenue Refunding Bonds	/AA/	6/1/2037	3.200%	74	Fed BQ		
Healthcare S	Sector									
<u>Date</u>	Par (\$ mil)	<u>Issuer</u>	<u>Project</u>	Ratings	<u>Final</u> <u>Maturity</u>	<u>Yield</u>	Spread to MMD	<u>Notes</u>		
1/22/2015	\$58.88	DASNY - Wyckoff Heights Medical Center	Hospital Impts	/AA/	8/15/2021	1.840%	42	Insured		
1/7/2015	\$62.74	King County WA Public Hospital District #2	Hospital Refunding Bonds	Aa3//	12/1/2031	3.400%	109			

Source: Bloomberg

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