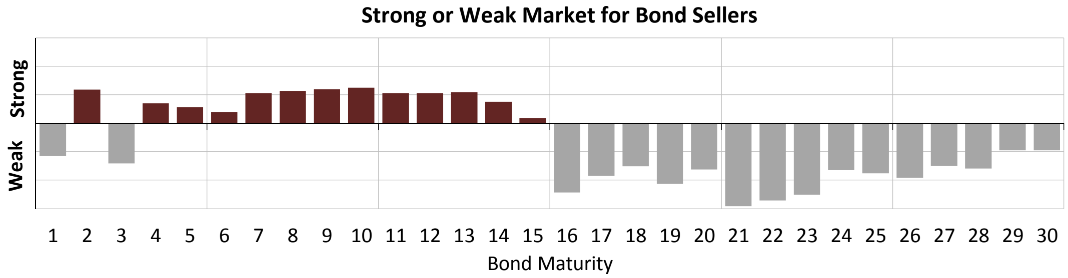
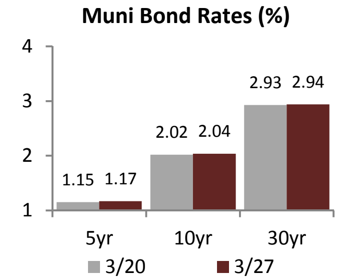
MUNICIPAL ISSUER BRIEF





*Heading into this week, a difficult dynamic has appeared for longer maturities after last week's adjustments. **MMA**'s metrics suggest stronger pricing for intermediate maturities. In Buyers Bites, shorter bonds are currently harder sells, because of mutual fund selling.*

MARKET UPDATE

AFTER STRONG START, WEEK ENDS WITH MIXED MESSAGES: March's unusual mid-month strength assisted issuers. However after the 24th, losses in other fixed-income sectors began to weigh on the tax-exempt market and produced some tentative pricing.

INVESTORS & ISSUERS: As quarter ends so do some present themes:

- As discussed last week, the end of recent quarters have been **a positive period for issuers.** It is not unusual for secondary market price discovery to be very important leading into quarter-end client statements sent by municipal portfolio managers. **March's high-grade issues were beneficiaries** as some investors are apt to be aggressive in buying municipal bonds because of this.
- The Florida Board of Education jumped on the competitive calendar on Monday and **benefited from pricing ahead of other issuers** (see **page 3** for more details on this deal and others).
- The positive momentum helped other issuers **to reduce borrowing costs,** but by Wednesday, the markets took a negative turn.
- Sparked by a poor U.S. Treasury auction on Wednesday (and again Thursday) broader fixed-income markets lost ground.
- Municipals appeared, at first, to ignore these losses but by Thursday afternoon the **MMA Municipal Price Index began to trend negative and the market started to exhibit stress.**
- The weakened conditions affected issuers that priced later in the week, and some issuers' deals were re-priced to higher yields .
- **Secondary selling pressure was at its highest of the year** last week, as several large asset managers sold their holdings. If this continues into month-end, the broader market may suffer.
- With the end of the quarter on Tuesday, the market shifts into a new phase in which the focus tends to be on income tax filings and **perhaps increased investor selling of their municipal holdings to pay the IRS.** However, April has been a positive month for municipals since 2006.

FITCH REPORT — ASSESSING 2014 RATINGS: Earlier this month, Fitch Ratings released a report, *U.S. Public Finance 2014 Transition and Default Study*, an annual study of the sector. Of note: Fitch's downgrades to upgrades were 0.7 to 1.0, which is a positive trend compared to last year's 2.0 to 1.0 ratio. Additionally, 3.4% of entities were downgraded, 4.9% were upgraded, and nearly 90.0% of municipal ratings were unchanged. The report noted that for the past 5 years, the long-term municipal default rate was 0.04%.

BUYERS BITES:

WHAT IS TRENDING HOT:
1) 4% coupons for AA or better outside of 10-years
2) Short-call options outperformed
3)Tobacco had large oversubscriptions

CURRENTLY HARDER SELLS:
1) Funds selling 10-years and shorter
2) Puerto Rico continues to challenge

WHO IS REPORTEDLY BUYING:
Mutual funds, large domestic banks, separately managed accounts (SMAs)

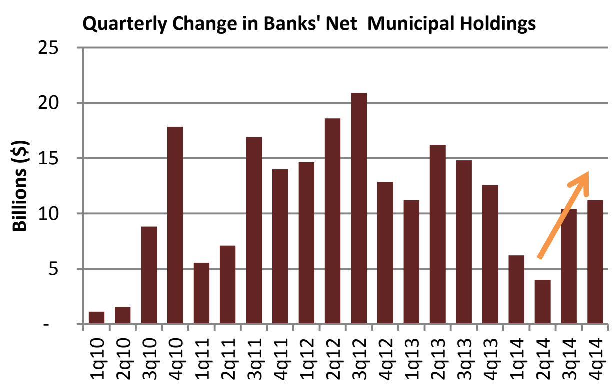


Figure 1*: For the first time since the start of 2013 banks increased their investments in municipals from one quarter to the next. The chart above tracks banks' portfolio purchases of municipal bonds since 2010. Over the period, this investor segment has become the 3rd largest, only behind mutual funds and individuals. Learn more about banks and other investor buying/selling trends on the next page's, **Topic of the Week**.*

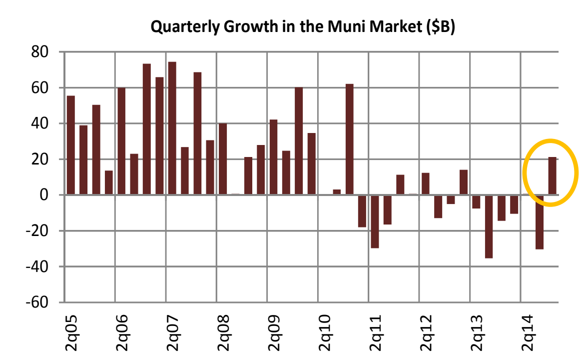
TOPIC OF THE WEEK: BOND BUYERS

BOND BUYERS: The latest data from the Federal Reserve generally shows a continuation of many of the prominent themes among municipal bondholders, but there are a few important deviations to note:

- Individual investors, or households, as they are categorized by the Fed, continued to invest in the market to a lesser degree;
- Mutual funds and other pooled investment vehicles continue to invest more;
- Banks continued to modestly rebound in their municipal purchases after a waning period (see **Figure 1**, **page 1** for more); and,
- Non-financial companies added $3 billion in municipal assets in the quarter—a big jump for a generally non-traditional investor class.

WHAT THIS MEANS FOR YOU: An issuer coming to market should consider the ever-changing investor dynamics of the market-place. It is important to coordinate with the underwriter and advisor to structure and market your issue to the most suitable audi-ence. **Individual investors** continue to hold fewer municipal bonds directly but cumulatively this investor segment still holds more than 40% of all outstanding municipal debt (**see table, below left**). **MMA** observes that individuals are utilizing professional manag-ers more through a **mutual fund** or managed account. This is a positive for the market, as it means credit headlines are better in-terpreted to the holder by a manager. **Banks** increased their investments from the previous quarter for the first time since 2013. This is an important buyer-base issuers may want to appeal to. Smaller issuers can attract demand from community banks, while larger issuers can market to the larger money-center banks that have specific buying strategies. The 5 largest municipal investment portfolios of banks total more than $120 billion. Also, many banks are interested in the relative value of tax-exempts versus other fixed income classes, against which municipals appear to be an attractive investment. The value has also attracted **non-financial companies** to the space. While this is a small segment of the buyer-base, the group did add $3 billion of municipals in the quarter. As a non-traditional investor, issuers may benefit from learning about what types of structures in which these buyers are interest-ed. Finally—the Fed data shows the size of the entire market, which grew in 4Q14, after a year of decline (**see chart, below right**). The growth may reflect a longer-term positive for the U.S. economy, indicative that state and local entities are borrowing to main-tain and grow infrastructure.

Investor Segment	Amount Invested ($B)	% of Market
Households	1540.4	42.18%
Money Funds	281.7	7.71%
Mutual Funds	673	18.43%
Closed End Fds	84.8	2.32%
Non-Fin. Cos.	9.8	0.27%
Banks	454.2	12.44%
Broker Dealers	18.9	0.52%
Prop/Cas. Ins.	326.4	8.94%
Life Insurers	149.3	4.09%
GSEs and Gov'ts	10.6	0.29%
Foreign Buyers	78.8	2.16%
Total	3652.4	100.00%



NEWS FROM STATE TREASURERS

PRIVATE ACTIVITY BONDS IN JEOPARDY? At last week's Nation-al Association of State Treasurers' (NAST) Washington meeting, numerous state and local officials focused on maintaining the tax-exemption. Other tax experts, including Dennis Zimmerman from the American Tax Policy Institute, commented. He said that while he understood the need for the tax-exemption to stay in place for public purpose projects, <u>the exemption should be eliminated for all private-activity bonds (PABs)</u>. PABs have come under fire in the past few years. Zimmerman's concept pushes further a provision in President Obama's proposed FY16 budget, which would in essence <u>eliminate the tax-exemption for bonds issued for professional sports stadiums</u>. While **MMA** continues to believe that comprehensive tax reform is unlikely this year, eliminating various tax-exempt provisions around the edges, such as private activity bonds, could gain greater attention as this debate ensues.

CAP PROPOSALS HERE TO STAY: Also at the NAST conference, Treasury Department official Kent Hiteshew commented on the 28% cap on taxpayers' deductions and exemptions, including interest on tax-exempt bonds. Hiteshew was careful to point out that <u>the proposal is not specifically aimed at this sector, but ra-ther is part of a grander tax policy reform proposal</u>, supported by the President. **MMA** sees this as an irrelevant point.

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

Three large deals that impacted the market last week (highlighted):

- The **Florida Board of Education** opted to sell via competitive bidding on Monday—announcing the deal with only 18-hours notice. This issuer gives itself flexibility in doing this and in this instance it paid dividends, as the issuer got ahead of a busy new-issue week and sold bonds before the weakness that permeated the market in the latter half of the week.
- The **Golden State Tobacco Securitization Corp.** is the entity that sells tobacco bonds for the state of California—and it happened to be the largest issuer of the week. After two days of retail orders, the entity closed the books on Wednesday with lower yields—again just ahead of market weakness.
- The **Virginia College Building Authority** ended up taking the brunt of difficult market conditions, finding little retail interest on its first day of pricing and eventually closed the account on Thursday when bond markets were in decline.

NORTHEAST

3/24: **Hopewell Township, New Jersey** sold $8.3M general obligation bonds to **Roosevelt & Cross Inc.**; NR/AAA/NR; callable at par in 4/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2016	2.00	0.20	-1
2025	2.00	1.80	-22
2032	3.00	2.85	+27

Notes: State budget woes did not affect this Township's deal

MID-ATLANTIC

3/26: **JPMorgan Securities LLC** priced $668M educational facilities revenue and revenue refunding bonds for the **Virginia College Building Authority**; Aa1/AA+/AA+; callable at par in 2/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.38	+23
2025	5.00	2.20	+19
2035	4.00	3.31	+61

Notes: Issuer forced to raise yields as much as 13 basis points

MIDWEST

3/23: **Bernardi Securities Inc.** priced $3.9M general obligation bonds for the **Stephenson Co. CUSD 202, Illinois;** NR/A+/NR AGM enhancement; callable at par in 1/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2017	2.00	0.90	+44
2025	3.00	2.60	+58
2031	4.00	3.20	+71

Notes: Insurance may have been added because of state problems

SOUTHEAST

3/23: The **Florida Board of Education** sold $247M public education capital outlay refunding bonds to **Citigroup Global Markets Inc.**; Aa1/AAA/AAA; callable at par in 6/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.33	+18
2025	5.00	2.05	+3
2035	4.00	3.13	+41

Notes: Some insurance companies prefer 4% coupons out long

SOUTHWEST

3/25: **RBC Capital Markets** priced $37.3M general obligation bonds for the **Midway Independent School District, Texas**; NR/AA/NR, PSF NR/AAA/NR; callable at par in 8/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2015	2.00	0.25	NA
2020	5.00	1.47	+32
2025	5.00	2.20	+18

Notes: This short-maturing deal found strong bank interest

FARWEST

3/25 **Citigroup Global Markets Inc.** priced $1.7B enhanced tobacco settlement asset-backed bonds for **Golden State Tobacco Securitization Corporation, California**; A1/A/A; callable at par in 6/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.46	+31
2026	5.00	2.43	+31
2045	5.00	3.38	+45

Notes: Re-priced 2 to 12 basis points lower on day 3 of orders