Municipal Market
UPDATE

November 5, 2014

SternBrothers&Co.
INVESTMENT BANKING SINCE 1917

- Muni Volume Continues to Increase
- Variable Rate Market Update
- Chapter 9 Precedents Begin to Offer Clarification

Muni Volume Continues to Increase

Issuance for the month of October totaled $34 billion, a 17.7% increase from the same period in 2013. Refundings significantly contributed, as $12.34 billion marks a 67.4% increase compared to October 2013 levels. Unlike September, new money issuance also increased by 3.6% from its year-to-year levels, totaling $17.28 billion.

The Municipal Market Data ("MMD") 'AAA' Muni Market 10 year yield ended October at 2.07%, a 10 basis point decrease from the end of September. The 30 year yield also decreased 8 bps, from 3.09% at the end of September to 3.01% to end October.

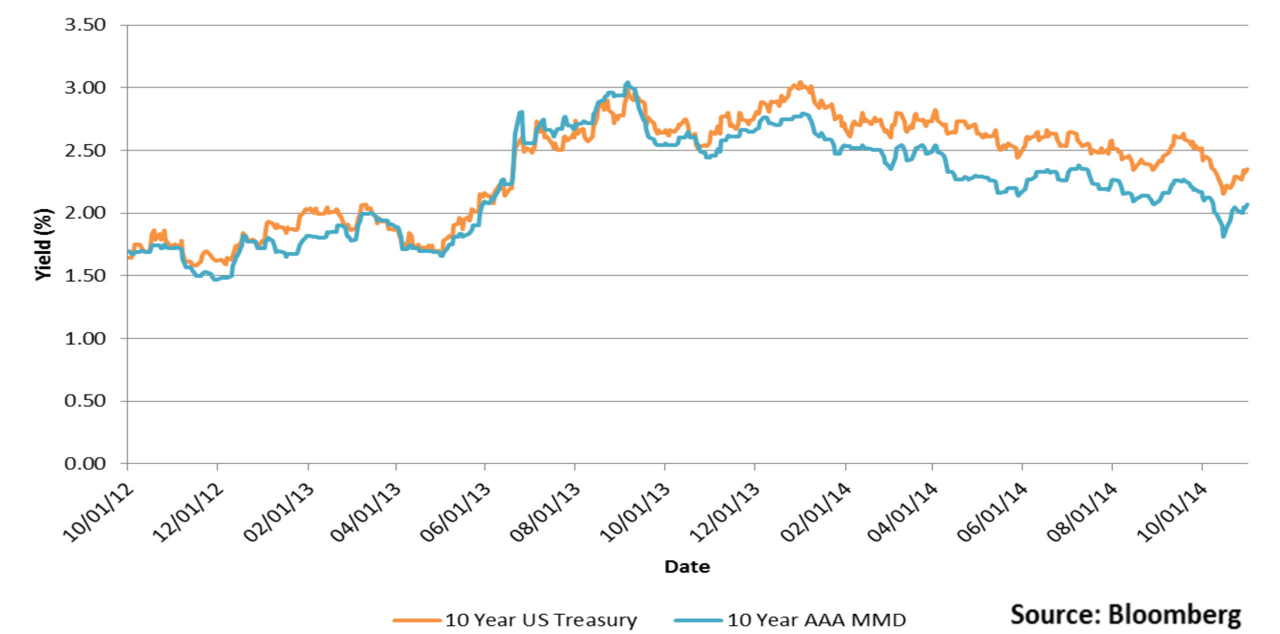
The 10-year US Treasury yield ended October at 2.35%, down 17 bps from 2.52% at the end of September. The 30-year Treasury yield also decreased, dropping from 3.21% at the end of September, to 3.07% to end October.

As of October 31st, the ratios of 'AAA' General Obligation municipal yields to Treasury yields were:

Year	Yield	% Yield
1-Year	0.14 / 011	127.27%
5-Year	1.12/1.62	69.14%
10-Year	2.07/2.35	88.09%
30-Year	3.01/3.07	98.05%

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

Figure 1 - 10 Year AAA MMD and 10 Year US Treasury



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Variable Rate Market Update

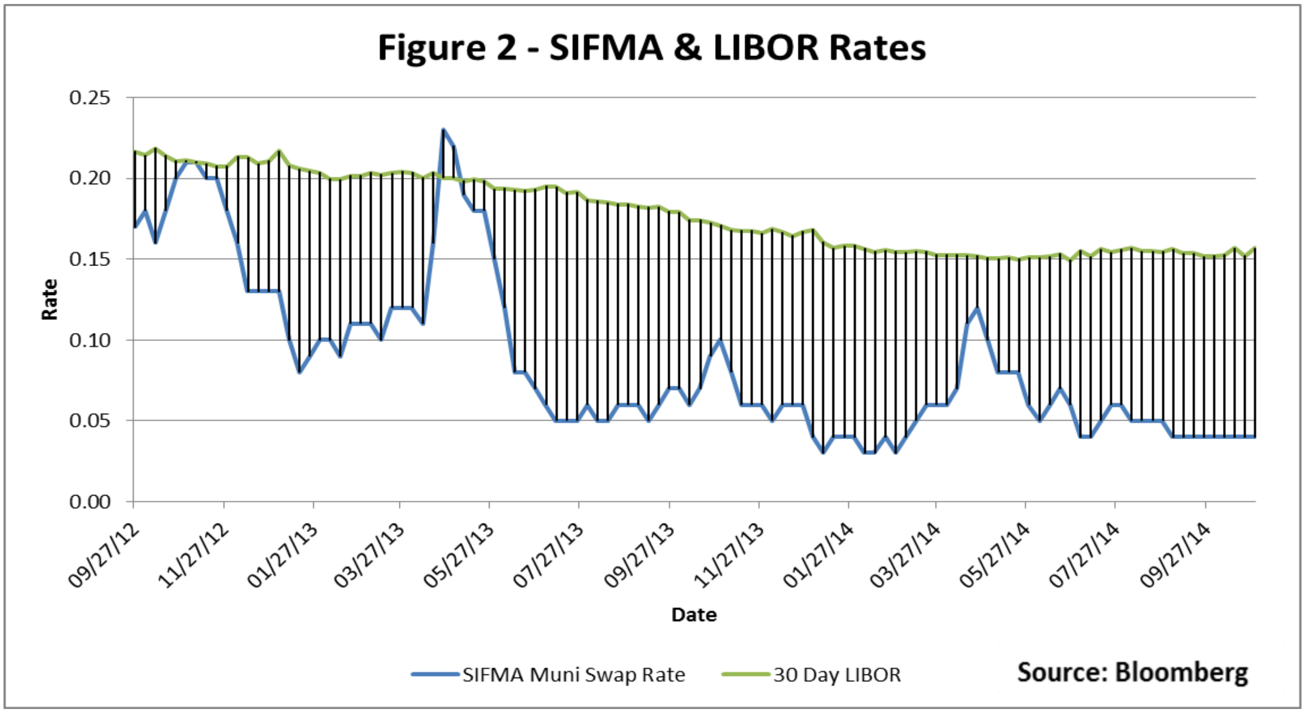
The SIFMA Municipal Swap Index, an average of high-grade, tax-exempt, variable rate bonds, ended October at .04%, unchanged from the level seen at the end of September. The 30-day LIBOR increased in the month of October, beginning the month at .1520% and ending at .1567%. Please refer to Figure 2 below for historical SIFMA and LIBOR rates.

Sources: The Bond Buyer, Bloomberg, SIFMA

Chapter 9 Precedents Begin to Offer Clarification

Chapter 9 of the U.S. Bankruptcy Code, as currently formulated, was created in the mid-1970s in anticipation of New York City's need to find some way to restructure its finances. The Big Apple was able to avoid the ignominy and rebuilt its finances outside of the courtroom, and until recently other cities and counties facing financial trouble have been able to do the same. The big issuers that did need to file for bankruptcy, such as Orange County, CA in 1994, found themselves in court, a result of mismanagement as opposed to rampant liabilities. As a result, there has been very little precedent created by the courts in the application of Chapter 9 to reduce an issuer's debt.

In the aftermath of the financial crisis however, declining tax revenues finally exposed some long troubled cities as overleveraged; and the underused Chapter 9 was finally going to be rolled out to pare down a filer's liabilities. Its days as a moot



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court topic are over as federal judges have had to weigh the competing claims of investors, tax payers, and pensioners, and apply new Chapter 9 law; particularly in Detroit, Michigan and Stockton, California which are both approaching final approval. While it's probably not true that the largely blank canvas of Chapter 9 has been completely filled in, large sections of the painting have been filled in for investors going forward. Among the issues where some clarity has been provided are:

1). Conflict with State Constitutions: Both the California and Michigan Constitutions offered protections for the inviolability of the pensions of public workers. Though long suspected but never tested, the judges in both the Stockton and Detroit cases found that such inviolability doesn't apply in bankruptcy court, federal law superseding state law, even constitutional state law. States can still control when a subdivision can enter bankruptcy, but once there they will play ball by the federal rules. Although it did not apply in either of these cases, investors would be wise to presume that state laws protecting bondholders, particularly common in school bonds, will also evaporate in court.

2) Pensions Can be Cut, But Probably Not by Much: The judges in both Detroit and Stockton found that unfunded pension liabilities and general obligation bonds are both in the same class as unsecured creditor claims. Then both judges turned around and treated pensions as senior claims and enforced much stiffer haircuts on bondholders than pension beneficiaries. Everyone has long suspected that despite what is said in negotiations with public worker unions, when they get to the courthouse it's not feasible for any politician of any stripe to suggest that bondholders and pensioners be treated equitably. What's now known is that bankruptcy judges are going to feel the same. This would not be news to anyone who followed the workouts of GM and Chrysler in their bankruptcies where the unions received vastly preferential treatment over bondholders. General obligation bondholders should consider themselves to be a subordinate class to pension liabilities despite what appears on paper.

3) Lease Obligation Bonds Run the Gamut: One area where long held municipal bond investor assumptions held true was in the treatment of lease obligation bonds (a form of appropriation bonds). Particularly in Stockton, the more critical a project funded lease obligation bonds was to the city's long term future, the higher the recovery values for bondholders. This is known as essentiality to investors, who have long believed that even the most obstinate of bankruptcy filers would not dig in their heels and risk losing the lease on their police station. They would be more than happy to hand you the keys to a golf course or parking garage, however, if you didn't like what was offered. This has proven to be true almost down the line. Pension obligation bonds in Stockton fared particularly poorly with proposed settlements with bond insurers and investors of pennies on the dollar, this in spite of the fact that the moneys raised remained invested in the City's pension plan. For their part, public employees in Stockton lost their post-retirement health care

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benefits and the judge found that these were not constitutionally protected.

4) Revenue Bonds Continue to Rise: One of the things that surprised financial planners during the recent recession was how people prioritize their finances under duress. Almost everyone who took a personal finance class in high school or college learned that you are supposed to prioritize your payments by their importance: i.e. you make your mortgage payment first so you don't lose your house, you make your car payment second, and then you work on other bills. When the 2008 recession hit and it came time for distressed people to prioritize their payments, no one reacted the way they were taught to (or that mortgage bond holders believed that they would for that matter). People instinctively made their car payments first because if you lose your car today, you'll lose your job tomorrow and the house the day after regardless of how current you are. People that had already lost a job paid their internet and electricity bills before their mortgage and taxes as well. No internet, no way of finding another job.

Just as people instinctively knew which bills to pay, investors have, over the last several years, begun to sense that utility revenue bonds may be better credits than the cities where those utilities are located, and that has proven to be true. People are more likely to make their utility payments than pay their taxes. The government will eventually take your house if you don't pay taxes but it will take years for them to do so whereas the electric company will cut you off next month. The utility revenue bonds in Stockton and Detroit emerged mostly unimpaired in contrast with general obligation bonds.

5) Going Bankrupt is Expensive: Chapter 9 is likely to remain a last resort for cities, as opposed to the strategic bankruptcies of corporations. The process has proven to be financially expensive for these two cities as well as Jefferson County, Alabama and other recent filers. Finances aside, it puts virtually every aspect of public life on hold in these municipalities and has proven to be a very painful process with real human costs in the form of increased crime. It has been speculated that after seeing cities like Detroit get a chance to arrest decades of decline by filing bankruptcy and drastically cutting their debt that other, less distressed cities would be tempted to do the same. It would be hard to imagine someone running for office on a platform of going through what Detroit and Stockton have gone through.

Sources: Moody's, S&P, The Bond Buyer, Thomson-Reuters

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October 2014 Selected Bond Issues

General Obligation and Essential Service Revenue

Date	Par ($ mil)	Issuer	Project	Ratings	Final Maturity	Yield	Spread to MMD	Notes
10/1/2014	$13.62	Travis County, TX	General Obligation Bonds	Aaa/AAA/	3/1/2034	3.100%	37	
10/8/2014	$5.30	Egg Harbor, NJ	General Obligation Bonds	/AA/	10/15/2043	4.070%	110	Fed BQ / Insured
10/14/2014	$7.93	City of Newark, OH	General Obligation Bonds	/AA/	12/1/2031	3.490%	113	Insured
10/30/2014	$5.29	City of Lincoln, IL	General Obligation Bonds	/A+/	12/1/2023	2.650%	72	Fed BQ

Education Sector

Date	Par ($ mil)	Issuer	Project	Ratings	Final Maturity	Yield	Spread to MMD	Notes
10/23/2014	$16.03	Albany NY Capital Resource Corporation	College & University Impts. Refunding Bonds	/BBB/A-	12/1/2034	4.030%	134	
10/23/2014	$36.94	Grand Valley MI State University	Revenue Bonds	/A+/	12/1/2034	3.840%	115	
10/28/2014	$28.06	Oakland University, MI	Revenue Bonds	A1/ /	3/1/2039	3.270%	44	
10/30/2014	$9.03	Richmond County GA Development Authority	Refunding - GA Regents University Student Center Proj.	/AA/	7/1/2034	3.660%	99	Insured
10/30/2014	$66.77	Central Michigan University	Revenue Bonds	Aa3/A+/	10/1/2044	4.010%	103	

Water/Utility Sector

Date	Par ($ mil)	Issuer	Project	Ratings	Final Maturity	Yield	Spread to MMD	Notes
10/1/2014	$8.58	Arab, AL Waterworks Board	Water Revenue Bonds	/AA/	8/1/2031	3.300%	69	Fed BQ / Insured
10/1/2014	$11.59	City of Laredo, TX	Water Revenue Bonds	A1/AA-/	3/1/2044	3.880%	85	
10/7/2014	$6.10	City of Joliet, IL	Waterworks & Sewage Revenue Bonds	/AA-/	1/1/2022	2.450%	78	Fed BQ
10/8/2014	$55.23	City of Grand Rapids, MI	Sanitation Sewer System Revenue Bonds	Aa1/AA+/	1/1/2044	3.350%	38	
10/30/2014	$7.52	Missouri State Environmental Improvement & Energy Resources Authority	Henry County Water Project Revenue Bonds	/A-/	11/1/2026	2.850%	61	

Source: Bloomberg

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Healthcare Sector

Date	Par ($ mil)	Issuer	Project	Ratings	Final Maturity	Yield	Spread to MMD	Notes
10/1/2014	$43.82	Karnes County TX Hospital District	Hospital Revenue Bonds	/ /BBB	2/1/2044	4.650%	162	
10/15/2014	$29.72	Build NYC Resource Corporation	Revenue Bonds (NY Methodist Hospital Project)	Baa1/ /A-	7/1/2030	3.640%	145	
10/22/2014	$50.00	Alachua County FL Health Facilities Authority	Hospital Revenue Bonds	A3/A-/	12/1/2034	3.710%	106	

Source: Bloomberg

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