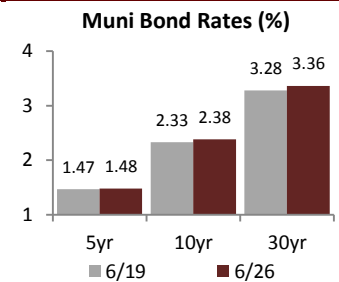
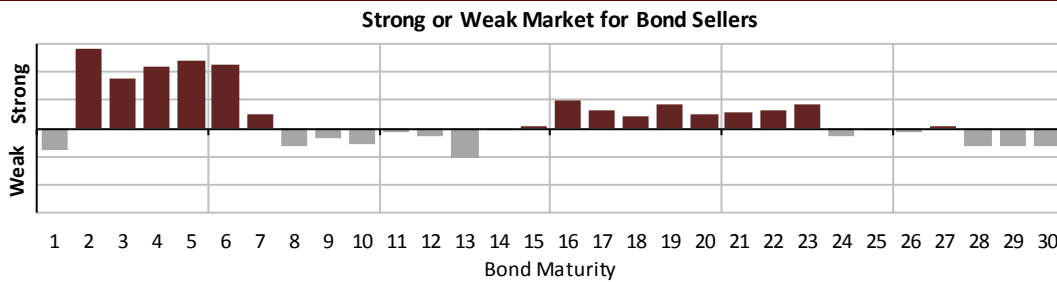


MUNICIPAL ISSUER BRIEF



Heading into this week, while municipals were more stable than their taxable counterparts, the current pricing environment is not as accommodative as last week.

MARKET UPDATE

MARKET REMAINS STEADY DESPITE BIG HEADWINDS: Municipal issuers continued to find demand for bond deals last week even as U.S. Treasury bonds declined nearly every single day.

INVESTORS & ISSUERS: Municipal market fares well:

- While yields rose modestly last week from start to finish, municipals outperformed the U.S. Treasury market. **Structurally constructive themes remained at work for municipals.**
- This included a continued steady support from large banks, insurance companies and the presence of retail in the space as yields neared or surpass 12-month highs (**Figure 1** on bank demand).
- Massachusetts GO was the week’s largest deal, which despite starting to price on a day when Treasuries sold-off, **was able to close the account with only minor price changes** (**page 3** for more details).
- Wayne County, Michigan, which includes Detroit, issued taxable notes last week. **The credit concerns in this part of the country negatively impacted the deal** (**page 3** has more details).
- Looking forward, issuance declines this week given the Fourth of July holiday. Texas Transportation Commission leads the calendar. Texas has seen issuance rise this year and as a result spreads **have widened** on the most common credits.
- Today, **rate markets rallied** on renewed concerns about Greece, and this bodes well for issuers this week.
- Events over the weekend were very negative for Puerto Rico as the Governor of that territory called its debt “unpayable.” Various credits are declining significantly in response. Should Puerto Rico negative media headlines prompt mutual fund redemptions then **the primary pricing environment could become problematic.**

PRICE GUIDANCE: The IRS has re-proposed [issue-price rules](#) for municipal securities. In 2013, the IRS proposed changing the issue-price rules that would have replaced the 10% reasonable expectation test for determining the issue price, to 25% of actual sales per maturity. The latest proposal states that the issue price would be determined through 10% of actual sales, and there are other mechanisms to achieve the issue price if the actual sales test can’t be met. Comments are due in late September, and the IRS plans on holding another hearing on the matter.

BUYERS BITES:

WHAT IS TRENDING HOT:

- 1) Longer maturities outperformed last week
- 2) New York City issuers
- 3) Massachusetts GO

CURRENTLY HARDER SELLS:

- 1) Puerto Rico
- 2) tobacco-backed securities
- 3) Some TX credits have widened

WHO IS REPORTEDLY BUYING:

Large banks, insurance companies, SMA and UIT structures for retail

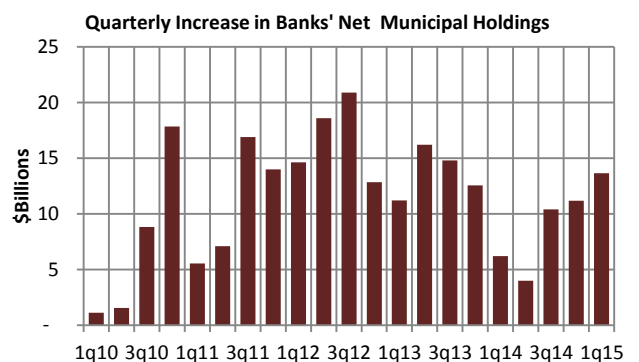
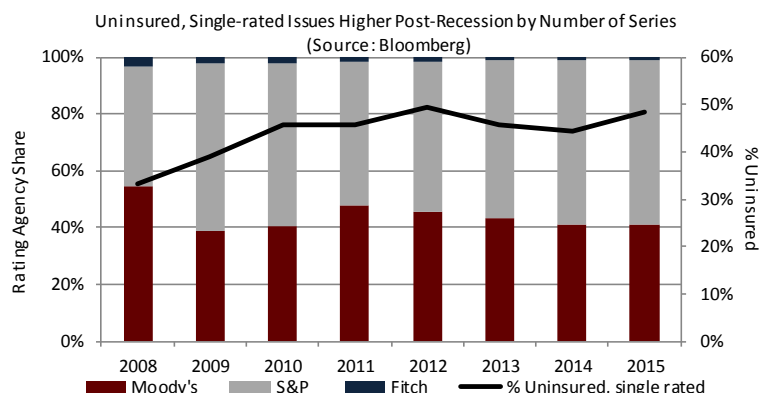


Figure 1: The latest data from the Federal Reserve for the 1Q15 showed that banks increased their investment in municipal bonds by \$14 billion. This marks the 4th straight quarter in which banks increased their investments from the prior quarter and 5 straight years in which banks have added to and not subtracted from their municipal bond portfolio.

TOPIC OF THE WEEK: RATING TRENDS

RATING TRENDS: Recent statistics (see [chart, below](#)) show that municipal issuers are increasingly **A)** choosing to go with fewer than 3 rating agencies on a deal, **B)** choosing a single rating agency for their deal, and **C)** in some cases deciding to discontinue the use of a lower and/or more costly outstanding rating. The trend toward fewer and higher ratings per transactions is likely to persist for the medium term as Dodd-Frank related compliance costs (including adherence to new Municipal Advisor rules) have made issuers even more particular when measuring the costs of coming to market. Increasingly, cost-conscious issuers are weighing the benefits of paying for a second or third rating agency more heavily. Part of the impetus behind issuers going with fewer rating agencies is methodology differences between the agencies themselves and increases in ratings costs. Recall that Moody's saw a small bump in market share in 2011 following its rating recalibration in 2010. Since then, S&P has had the advantage with its upgrading in the local government bond sector, as a result of criteria changes. You can read more about rating trends [here](#) and [here](#).

WHAT THIS MEANS FOR YOU: As budget pressures become more acute for many states and localities (in part as accounting standards change for pension liabilities), decreasing the cost of issuance via paying less for a rating(s) is a short-term solution to reducing issuance costs. However, MMA views that less credit information can undermine retail investor confidence and as a result narrow demand for new bond offerings and increase borrowing rates. It also provides less credit guidance to issuers themselves. Many decision makers at the state and local levels use ratings to guide and legitimize financial decisions. Thus, fewer ratings imply a partial disconnecting of governmental policies from traditional rating actors. This is a negative development amid expectations for longer-term budget challenges for some. Additionally, if there is a growing consensus amongst the investor base that issuers are choosing a single rating simply because they expect that rating to be higher, it erodes confidence in the issuer's decision-making to a certain extent. This recently received significant press when the city of Chicago removed its Moody's rating in wake of the agency downgrading it to junk. This trend of fewer rating agency use also aligns to a certain extent with investors questioning the agencies themselves, in the wake of the financial crisis. If rating agencies have less credibility with the issuer community, it does not bode well for investor confidence either.



IN THE NEWS

PENSIONS REPORT: Earlier this month the Boston College Center for Retirement Research, [released a 13-page briefing paper](#), *The Funding of State and Local Pensions: 2014-2018*. The key findings of the paper include:

- During 2014, public plans adopted new accounting standards for reporting purposes but continued to use the traditional standards for funding purposes.
- The traditional funded ratio rose from 72% in 2013 to 74% in 2014—the first improvement since the financial crisis.
- Required contributions continued to climb in 2014, but plans stepped up their payments from 82% to 88% of the required amount.
- The outlook for the next several years suggests continued steady improvement in funding unless plans experience lower than assumed asset returns.

GASB ON OPEBS: The Governmental Accounting Standards Board (GASB) [approved three statements](#) of importance to state and local governments in early June. GASB Statement 74: *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*, addresses [reporting standards for OPEB plans](#) that administer benefits for governments. “The Statement requires more extensive note disclosures and RSI related to the measure-

ment of the OPEB liabilities for which assets have been accumulated, including information about the annual money-weighted rates of return on plan investments. Statement 74 also sets forth note disclosure requirements for defined contribution OPEB plans.” GASB Statement 75: *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* replaces Statement 45 and was adopted [for governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments](#). It “requires governments in all types of OPEB plans to present more extensive note disclosures and required supplementary information (RSI) about their OPEB liabilities.”

On the pension side of things, GASB approved Statement 73: *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. This new statement “establishes requirements for those pensions and pension plans that are not administered through a trust meeting specified criteria (in other words, those not covered by Statements 67 and 68).”

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

Three large deals that moved the market last week and why (highlighted below):

- **Massachusetts** attempted to come to market with aggressive spreads to start last week but a sell-off in the Treasury market forced it to make minor adjustments. Still, the levels were good from a historical perspective. Additionally, the state's success, given the broader negative rate dynamics, spoke to the continued positive technicals at play for most issuers.
- **Wayne County, Michigan** closed a taxable note deal with a 5 3/4 coupon at 6% after initially attempting to price the deal 5s at par. This was a significant adjustment and largely attributed to the county's fiscal links to the city of Detroit.
- **Seattle's** power and light revenue bonds sold competitively to Bank of America Merrill Lynch at aggressive spreads. The issue was also nearly entirely sold before the day ended. The dealer community has broadly been able to lower inventory holdings during June, and this has contributed to the ability to aggressively bid select issues, such as the Seattle deal.

NORTHEAST

6/24: **Bank of America Merrill Lynch** priced \$954 million general obligation bonds for **Massachusetts**; Aa1/AA+/AA+; callable at par in 7/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.58	+10
2025	5.00	2.55	+19
2045	5.00	3.58	+25

Notes: At tight spreads this deal did well given broader market

MID-ATLANTIC

6/22: **RBC Capital Markets** priced \$5.6 million sewer revenue bonds for the **Lower Lackawanna Valley Sanitary Authority, PA**; NR/A/NR (Municipal Assurance Corp. NR/AA/NR); callable at par in 9/15/2022:

Maturity	Coupon	Yield	+/- AAA 5%
2020	2.00	2.08	+60
2025	3.00	3.10	+76
2027	3.40	3.40	+82

Notes: MAC insurance boosted demand

MIDWEST

6/25: **Bank of America Merrill Lynch** priced \$187 million federally taxable general obligation limited tax notes for **Wayne County, MI**; NR/SP-1/NR; callable at par in 12/1/2016:

Maturity	Coupon	Yield
2017	5.75	6.00

Notes: Detroit's effects were felt in this taxable deal

SOUTHEAST

6/24: **Wells Fargo Securities** priced \$29.4 million general obligation refunding bonds for **Durham, NC**; Aaa/AAA/NR; non-callable:

Maturity	Coupon	Yield	+/- AAA 5%
2018	5.00	1.16	+17
2020	2.00	1.61	+13
2025	5.00	2.42	+6

Notes: The 2% coupon in 5-years saw very strong demand.

SOUTHWEST

6/24: **FirstSouthwest** priced \$8.1 million limited tax refunding bonds for **Hutto, TX**; NR/AA-/NR; callable at par in 8/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	3.50	1.63	+15
2025	4.00	2.31	-5
2032	4.00	2.93	-5

Notes: Bank-qualified increased demand for this issue

FARWEST

6/23: **Seattle, WA** sold \$164 million municipal light and power revenue bonds to **Bank of America Merrill Lynch**; Aa2/AA/NR; callable at par in 5/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.62	+14
2025	5.00	2.55	+21
2045	4.00	4.00	+69

Notes: True interest cost was 3.582% with 6 bidders.