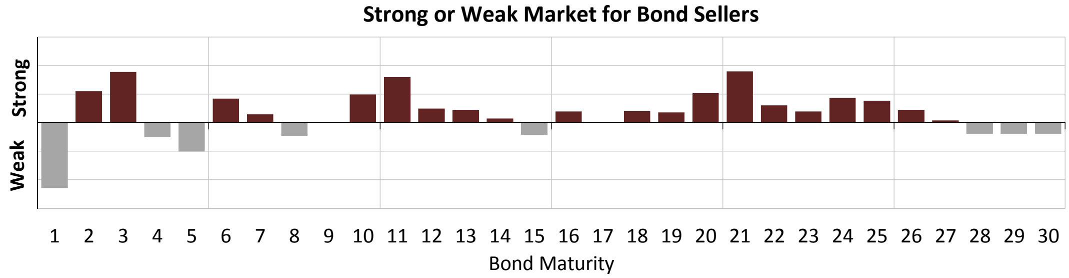
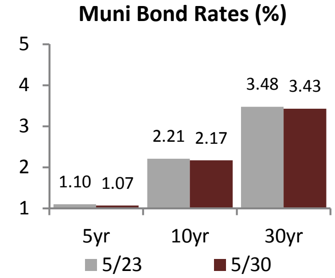
MMA The Power of Independence

JUNE 2, 2014

MUNICIPAL ISSUER BRIEF





Heading into this week, the recent rally moved municipal rates lower yet again and pushed several of the columns into 'strong' territory for issuers. The long end has moved into the 'weak' category as some noted it was over-bought thereby investors may not be as aggressive in the near future.

MARKET UPDATE

MUNICIPALS CONTINUE TO DEFY EXPECTATIONS: After a slow start to the week a rally in the Treasury bond market spurred a better tone for municipal bonds. Most new-issues found very strong investor reception at near 12-month lows for borrowing costs.

INVESTORS & ISSUERS: Reversing the prior week: bond markets rally.

- A rally in the Treasury market that began on Wednesday **carried municipal bonds along for the ride.**
- **The limited amount of new-issuance found extremely strong investor interest**, most notably Chicago's Midway Airport and DC's Airport Authority bond deals the latter of which saw more than $2 billion of orders placed on the $550 million offered, which resulted in lowering of rates paid.
- **One point of caution was the lack of secondary activity** as many municipal bond traders and investors find the current low rate environment difficult to swallow. As a result, there is less trading, which could be problematic if markets take a turn for the worse.
- Meantime, NYC, NJ and even Illinois in the wake of either negative budget headlines or pension concerns, **all also improved with the rest of the market.**
- This is a sign that bond investors are willing to purchase most any security regardless of potential credit downsides. **It underscores just how strong the rally has been in recent months** but is not a good sign for the long-run as investors should be willing to penalize issuers if they believe their lenders are not acting in the best interest of their fiscal stability.
- This week issuance is only slightly higher and **we have no reason to believe positive results of late will not be replicated.**
- **We expect issuance to begin to increase later this month, which may start to tip the scales away from issuers.** Stay tuned.

BUYERS BITES:

WHAT IS TRENDING HOT:

1) AA or better out long led the charge
2) Airport bonds
3) AMT bonds
4) Healthcare

CURRENTLY HARDER SELLS:

1) Puerto Rico

WHO IS REPORTEDLY BUYING:

Large banks, mutual funds, SMAs

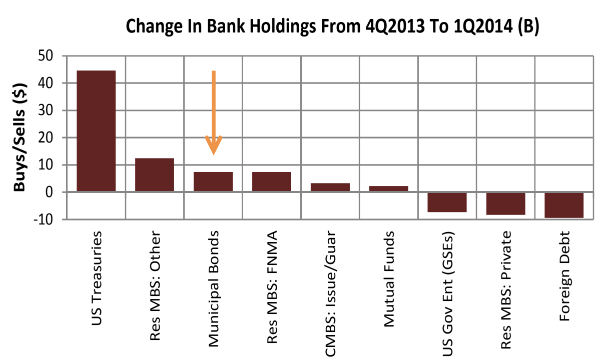


Figure 1: *From the end of 2013 through the first 3 months of 2014, banks increased their purchases of municipal bonds by $7 billion, according to **BankRegData**. That makes municipals the third most purchased asset class behind U.S. Treasury bonds and mortgage-backed securities. Bank have increased their purchases of municipal bonds enormously in recent years (more than $100 billion since 2012) and have become an integral demand component to keeping issuer borrowing rates low. New rules that have identified municipal bonds as not as easily tradable may limit the role bank's play in our market in the future.* *To learn more turn to **page 3** in this week's **Topic of the Week**.*

STUDENT LOANS A NEGATIVE FOR LOCAL GOVERNMENTS: The percentage of 25-year-olds with education loans reached 43% in 2012 compared to 25% in 2003, according to the New York Fed. The overwhelming debt level of young adults has altered the make-up of homeownership for the negative as potential young homeowners have been sidelined. For local governments, this may make it difficult to grow general fund coffers at a pace that will cover needed expenditure growth. While local government credit quality is generally stabilizing in the sector, these factors limit the upside for local governments' fiscal positions over the near- to medium-term.

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TOPIC OF THE WEEK

NEW RULES: Last Fall the Federal Reserve released a draft set of rules designed to help banks withstand credit crisis-like events by ensuring that they have available resources that can be quickly converted into cash to meet their needs during these times. This is part of an international effort to redesign financial markets to mitigate potential problems in the future. The rules qualify all different types of bank investments by how readily they could be sold by the bank. **Municipal bonds are not considered readily sellable (or liquid) assets like U.S. Treasury bonds, Federal agency bonds, or even corporate bonds and equity**. In recent months many in the state and local finance industry have sent letters to the rule-makers asking that they reassess their view of municipal bonds in hopes of having them fully or partially realigned into the higher tier of high-quality liquid assets (HQLA). Aside from the banks themselves trying to influence a change in the rules, by our count, 36 issuers have also sent letters to the rule-makers arguing for a change. Many of these argue that given the 30-day time period allotted by the regulators, municipal bond portfolios have recovered from even under the most stressed conditions with smaller price losses than those implied by a non-liquid designation.

WHAT THIS MEANS FOR YOU: If the rules are put in place as currently written banks may have to re-think the amount of municipal bonds they currently hold and how much they intend to buy going forward. This can affect issuer borrowing costs as banks are large holders of municipal bonds (see **Figure 2**, below) and have been increasing their holdings significantly in recent years (see **Figure 3**, below). That being said, **MMA** believes the net impact will be only modestly negative, in particular under normal or tight market conditions, such as the current marketplace. This is because we do not expect these rules to drive day-to-day investing decisions for most affected companies. However, the rules could affect longer-term planning as banks over time allocate capital away from municipals. Perhaps most important though is that if the markets were experiencing high volatility, we could see banks sell their municipals bonds at a time when issuers would most need bank support. **MMA** does not believe we will face another 2008-era crisis in the near term, but the market is currently deprived of significant dealer support so losing an element such as the bank support would be unwelcomed. Note the geographical disparity of just the top 25 bank holders of municipal bonds in the table. Many of these banks make a point to invest locally. The rule will be finalized by early next year. We suggest issuers learn more about their bank investors in the meantime.

Rank	Bank Name	June 2013 Holdings
1	Wells Fargo Bank Sioux Falls, S.D.	33.487 Billion
2	JPMorgan Chase Bank Columbus, Ohio	$21.218 Billion
3	Citibank Sioux Falls, S.D.	$18.774 Billion
4	State Street Bank & Trust Co. Boston	$8.223 Billion
5	Bank of New York Mellon	$6.486 Billion
6	US Bank Cincinnati	$5.741 Billion
7	Bank of America Charlotte	$4.339 Billion
8	Frost Bank San Antonio	$3.771 Billion
9	First Republic Bank San Francisco	$2.389 Billion
10	PNC Bank Wilmington, Del.	$2.829 Billion
11	BMO Harris Bank Chicago	$2.286 Billion
12	UMB Bank Kansas City, Mo.	$2.232 Billion
13	Branch Banking & Trust Co. Winston-Salem, N.C.	$2.198 Billion
14	First Security Bank Searcy, Ark.	$2.149 Billion
15	Sovereign Bank Wilmington, Del.	$2.018 Billion
16	Compass Bank Birmingham, Ala.	$1.725 Billion
17	Commerce Bank Kansas City, Mo.	$1.621 Billion
18	Glacier Bank Kalispell, Mont.	$1.307 Billion
19	FirstBank Lakewood, Colo.	$1.216 Billion
20	Wells Fargo Bank Northwest Ogden, Utah	$993 Million
21	First Financial Bank Abilene, Tex.	$958 Million
22	MB Financial Bank Chicago	$952 Million
23	Westamerica Bank San Rafael, Calif.	$914 Million
24	Old National Bank Evansville, Ind.	$839 Million
25	Bank of Hawaii Honolulu	$820 Million

Figure 2: *Above is a list of the 25 largest bank holders of municipal bonds as of last summer. Note that these banks are located all over the country and many tend to invest more locally.*

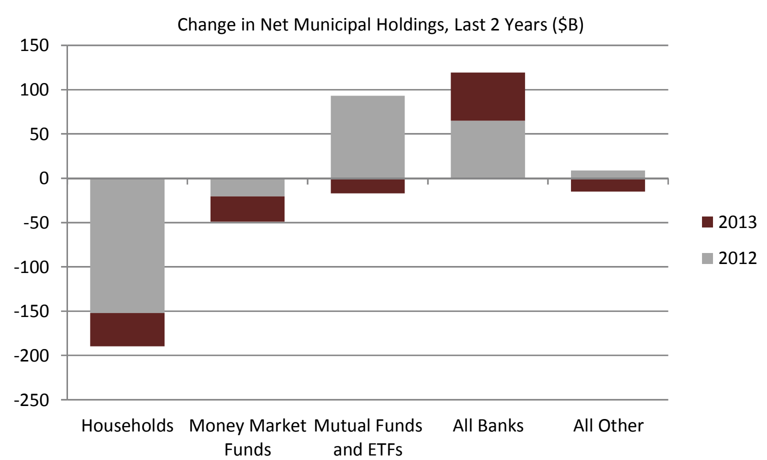

Figure 3: *Above we track the changes in buyers and sellers of municipal bonds through 2012 and 2013. Note how banks have added more municipal bonds than many other buyer categories.*

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

NORTHEAST

On May 29th, **JPMorgan Securities LLC** priced $351 million of Yale New Haven Health revenue bonds for the **Connecticut Health and Educational Facilities Authority**; Aa3/A+/AA-; callable in 7/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.36	+28
2024	5.00	2.65	+48
2034	5.00	3.60	+41

Notes: The issuer took advantage of high demand for health care

MID-ATLANTIC

On May 28th, **Arlington County, Virginia** sold $65 million of general obligation public improvement bonds to **Citigroup Global Markets Inc.**; Aaa/AAA/AAA; callable in 2/15/2022:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.03	-7
2024	3.00	2.26	+5
2034	3.75	3.45	+23

Notes: Lower coupons continue to show up in competitive HG deals

MIDWEST

On May 28th, **Barclays Capital** priced $775 million of AMT and non-AMT Chicago Midway Airport revenue bonds for **Chicago, Illinois**; A3/A-/A-; callable in 1/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.45	+35
2024	5.00	2.85	+64
2034	5.00	3.88	+66

Notes: Global demand for yield helped lower the airports costs

SOUTHEAST

On May 28th, **Stifel Nicolaus & Co. Inc.** priced $113 million of certificates of participation for the **Volusia County School Board, Florida**; Aa3/NR/A+; callable at par in 8/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.53	+43
2024	5.00	2.88	+67
2029	5.00	3.48	+72

Notes: The ~70ish spread for 10-years and out is good for this rating

SOUTHWEST

On May 28th, **JPMorgan Securities** priced $146 million of Memorial Hermann Health System revenue bonds for **Harris County Cultural Education Facilities Finance Corp**; A1/A+/NR; callable in 12/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2019	5.00	1.67	+57
2024	5.00	2.91	+70
2029	5.00	3.35	+55

Notes: This hospital was able to lower borrowing costs by 10bps

FARWEST

On May 28th, **Piper Jaffray** priced $49 million of unlimited tax general obligation bonds for **Issaquah SD No. 411, King County, Washington**; Aa1/AA+/NR; callable in 6/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2015	2.00	0.22	+3
2027	4.50	2.80	+13
2030	4.50	3.08	+18

Notes: This deal benefited from state credit enhancement

MA RULE UPDATE

The Securities and Exchange Commission (SEC) released another set of Frequently Asked Questions (FAQ) on the Municipal Advisor (MA) rule ahead of the July 1 implementation date. See more on MA rule in the 1/21/14 MIB. The FAQs address some outstanding matters for which participants asked clarification:

Advice vs. General Information. The FAQs do not develop a bright line definition for advice, but do provide numerous examples and comments about what can be defined as general information. General information would include market information, available products and even "information regarding a municipal entity's particular outstanding bonds, such as current market prices and yields."

'Rely On' Advice of MA. The issuer must state that it would "rely on" the advice of the municipal advisor, when using the Independently Registered Municipal Advisor exemption. To clarify what this means, the SEC said 'rely on' means the issuer will seek and consider the advice, analysis, and perspective of the independent registered municipal advisor. Rely on does not mean issuers must take the advice.

Investing Bond Proceeds. After July 1, those providing advice on the investment of bond proceeds must be registered as a municipal or investment advisor, unless an exemption is met. There has been concern that some outstanding issuer accounts may have comingled funds of bond proceeds and general funds or accounts and thus those advising under these funds would have to adhere to the rule. The SEC states both that professionals should use reasonable due diligence and obtain written representation by the issuer that the funds do not contain bond proceeds. The FAQs also state that "unless a market participant actually knows or reasonably should have known that an existing account or existing investment contains bond proceeds, [they] may determine that such existing accounts or existing investments do not contain proceeds of municipal securities."