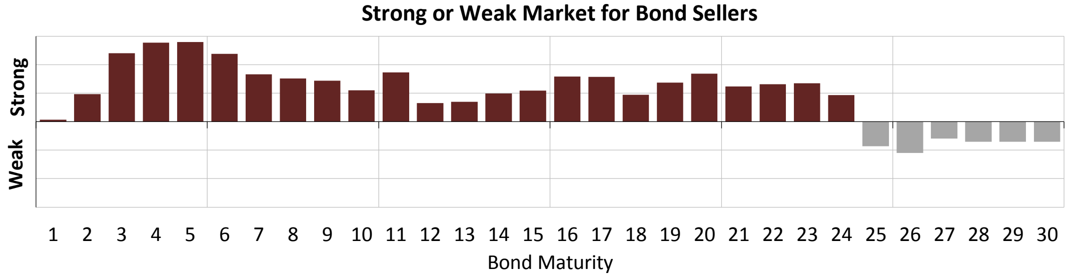
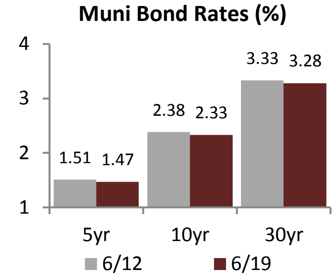
MMA Independent & Data Driven

JUNE 22, 2015

MUNICIPAL ISSUER BRIEF





Heading into this week, a strong dynamic remains largely in tact. The outperformance of municipals to other bond markets last week was also sustained. Issuers of longer-dated debt may find the current context more challenging.

MARKET UPDATE

MUNICIPALS WITHSTAND WORLDWIDE VOLATILITY: Last week the market for municipals was able to overcome world-wide rate volatility. Several positive themes remain in play that are apt to assist municipal issuers in the near-term.

INVESTORS & ISSUERS: Constructive factors present:

- **Underlying positive themes continue** in the current market construct that are generally favorable for issuers.
- While bond markets worldwide continue to see very high volatility, municipals are not experiencing similar large rate swings and **kept moving to lower yields** while other sectors struggled.
- Several elements include **continued retail support,** as yields have risen in 2015 to 12-month highs, **a sustained institutional bid** as we near the end of the 2nd quarter and several large **banks are also investing heavily** in the space.
- These steady investors can assist **issuers to take advantage of favorable pricing** if selling bonds in the near-term.
- Specifically, New York credits are seeing the largest increase in demand ahead of the seasonally large July reinvestment period (see **page 3** for more).
- Also several **higher education and healthcare issuers have been able to take advantage of the demand** and several are scheduled this week. Temple and Yale Universities are apt to serve as proxies for that sector.
- Still, an area of concern is the ongoing net investor exodus from municipal bond funds (see **Figure 1** for more).
- A specific event of market risk comes from Puerto Rico. The island may not make principal and interest payments on outstanding debt over the next month. If this occurs, along with increased scrutiny of Chicagoland issuers, **the possible coinciding volatility and uncertainty may disrupt issuers access to capital.**

SEC FINES: Last Thursday, the Securities and Exchange Commission announced the first round of Municipalities Continuing Disclosure Cooperation (MCDC) settlements against underwriters. Thirty-six firms were fined for violating securities laws by "using offering documents that contained materially false statements or omissions about the bond issuers' compliance with continuing disclosure obligations." The outcome and implications for these actions are likely to be felt through new industry practices and underwriters being more aggressive to ensure that issuers are complying with their continuing disclosure agreements.

BUYERS BITES:

WHAT IS TRENDING HOT:
1) Kicker coupons
2) Louisiana GO
3) New York issuers outperform

CURRENTLY HARDER SELLS:
1) Longer maturities

WHO IS REPORTEDLY BUYING:
Large domestic, regional and community banks, SMAs, insurance companies

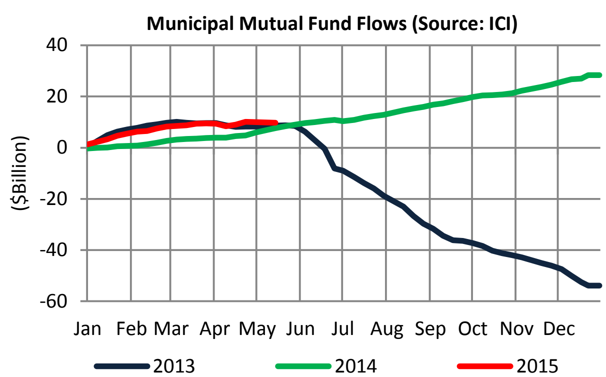


Figure 1*: Mutual funds are an important investor base in the municipal sector. The graph above illustrates the week-to-week amount of cash entering or exiting municipal mutual funds on a cumulative basis in 2013, 2014 and year-to-date in 2015. Often market performance is associated with whether mutual funds are experiencing net inflows or outflows. In 2013 the market sold off (making issuers' cost of capital higher) while in 2014 the opposite happened. Recently, in 8 out of the last 10 weeks, the funds have experienced modest outflows; thus the market is at a crossroads, as to whether it will follow the path of 2013 or 2014.*

TOPIC OF THE WEEK: WATER

WATER: A significant portion of California's Central Valley and beyond is now entering its fourth straight year of drought. The aftermath of Hurricane Sandy on the eastern seaboard has engineers thinking again about low-lying areas in the major urban centers which cover that part of the country. Thus, the topic of water has entered the forefront of many Americans' conversations across the country and how states and localities address the numerous issues related to water resources and infrastructure has entered the public finance arena. Complicating the credit profile for many issuers is changes in weather patterns, which are producing volatility in utility service provisions and revenues. In drought-stricken areas across the western United States, governments needing increased supply may be forced to purchase more water from peak-demand providers and/or invest in new infrastructure. Where water is in excess, storm water management can require improvements to treatment facilities and low-lying facilities must be fortified against rising seas. Recently, the Obama Administration adopted new language to the Clean Water Act, which while perhaps improving the quality of source withdrawals for drinking water, the net effect on utilities' finances could be negative because of increased burdens on wastewater treatment facilities. While water and sewer service remains generally affordable, customer rates are rising and we expect them to continue to rise. The American Water Works Association shows a nationwide residential average increase of 50% between 2004 and 2014. Noting pervasive utility manager conservatism in rate-setting and concern over ratepayer equity, we expect total collections to grow more slowly than expenses, to the detriment of bond rate covenant coverage. Tighter coverage means less flexibility for unforeseen developments and more potential for unexpected bond covenant violations.

WHAT THIS MEANS FOR YOU: Climate change implications on water resources and management may segue to credit profile erosion among some municipal water and sewer utilities, which leads to tighter bond covenant compliance and lower credit ratings. While U.S. municipal utilities tend to be well-run operations, the challenges noted above lead **MMA** to expect negative credit pressure on utility systems. In a note to institutional clients, **MMA** went further to note: "It is conceivable that, similar to their approach toward pensions, that rating agencies could shift water/sewer rating methodologies to overweigh supply sustainability and/or infrastructure adequacy concerns unlocking more sweeping or regional downgrade trends." Agricultural areas that suffer from drought may also see heightened focus in terms of credit change. In these areas, even safe-sector GO pledges could struggle as tax bases decline amid economic difficulties associated with climate change. Additionally, some governments have included information in their disclosure documents about water management and potential future climate change problems. This comes after the SEC released a paper in 2010, providing guidance to corporations on this matter, *Commission Guidance Regarding Disclosure Related to Climate Change*.

Another important implication for the broader market will be an increase in new bond issuance related to water and sewer infrastructure over the next decade. And it is not only at the state and local levels but also the federal government has jumped in the deep end on water issues. There are legislative proposals to expand private activity bond authority for water infrastructure, during ARRA and the years immediately following, federal funds to state revolving funds increased, although that has changed recently. Efforts to shore up the Highway Trust Fund could result in greater water infrastructure funding, as well. Finally, President Obama has called on Congress to allow for greater public-private partnerships to meet our water and other infrastructure needs.

DC HAPPENINGS

As mentioned **above** and with the current short-term extension of the Highway Trust Fund set to expire at the end of July, an emphasis on infrastructure keeps being raised in Congress, by the Administration, and others.

National Infrastructure Bank. Sen. Mark Warner (D-VA) has introduced the *Building and Renewing Infrastructure for Development and Growth in Employment Act* (BRIDGE, S. 1589), that would include benefits for water and other infrastructure needs. A highlight of the bill is the creation of a national infrastructure bank that would mostly provide loans to state and local governments with projects totaling $50 million or more that serve a public benefit (with 5% going toward rural projects that total at least $10 million). The federal government would fund the bank at $10 billion for the first two years, $20 billion for years 3-9, and after that $50 billion per year. The Senator estimates that the $10 billion in federal funds would be leveraged to $300 billion in loans during the first year of the program.

BABs Redux. Rep. Richard Neal and Sen. Ed Markey, both Democrats from Massachusetts, introduced the *Bolstering Our Nation's Deficient Structures Act of 2015* (S. 1515, H.R. 2676). This legislation would resurrect direct-subsidy Build America Bonds, and expand their usage to allow the financings to be used for refundings, as well as the subsidy being protected against any Congressional sequestration cuts. The bonds would have a direct subsidy rate of 32% in 2015, and would decrease by 1% each year until 2019, when a 28% rate would be enacted.

Fitch on Financing Options. Fitch Ratings released a report in early June that comments on the benefits of federal infrastructure programs available to state and local governments, in addition to the tax-exempt bonds. The report stresses the positive implications for both expanding the investor base and infrastructure investment if other types of federal financing programs were enacted, such as direct subsidy bonds, public private partnerships, and expanded private activity bond programs.

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

Three large deals that were important to the general market last week and why:

- The **New York City Transitional Finance Authority** was the largest deal of last week selling $750 million building aid revenue bonds. The deal had 2 days of retail orders in which it had to make minor yield adjustments. New York, a high-tax state, is a good proxy for general retail interest in the municipal market. The issue received strong retail reception and subsequent adjustments to lower yields, after taking institutional orders, and underscored the steady market context for issuers.
- Triple-A **Baltimore County** sold several competitive deals — with Barclays being the highest bidder for the larger series. The levels came tight to the **MMA Benchmark** indicating a more constructive dealer tone.
- The **Turnpike Authority of Kentucky** was so well received by individual demand, that it accelerated into institutional orders on its first day and was able to close the account in a single trading session.

NORTHEAST

6/17: **Goldman, Sachs & Co.** priced $750 million building aid revenue bonds for the **NYC Transitional Finance Authority**; Aa2/AA/AA; callable at par in 7/15/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.72	+24
2025	5.00	2.65	+31
2044	4.00	4.02	+74

Notes: 4% coupon out long the result of insurance company interest

MID-ATLANTIC

6/16: **Baltimore County, MD** sold $167 million general obligation bonds to **Barclays Capital Inc.**; Aaa/AAA/AAA; callable at par in 8/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.52	+3
2025	5.00	2.38	+2
2030	3.50	3.24	+40

Notes: The +2 spread in 10-years to the Benchmark was aggressive

MIDWEST

6/16: **Morgan Stanley & Co.** priced $193 million economic development road revenue and revenue refunding bonds for the **Turnpike Authority of Kentucky**; Aa2/AA/A+; callable at par in 7/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	5.00	1.81	+32
2025	5.00	2.76	+40
2035	4.00	4.05	+96

Notes: This deal was upsized as well as accelerated

SOUTHEAST

6/16: **Raymond James & Associates** priced $2.960 million limited obligation school bonds for the **Tenth Special School District of Wilson County, TN**; NR/AA-/NR; callable at par in 4/1/2023:

Maturity	Coupon	Yield	+/- AAA 5%
2020	2.00	1.70	+21
2025	2.50	2.04	-32
2035	4.00	3.35	+26

Notes: Bank-qualified, short-calls and small coupons a positive

SOUTHWEST

6/16: **Boulder, CO** sold $22.8 million storm water and flood management revenue bonds to **Wells Fargo Securities**; Aa1/AAA/NR; callable at par in 12/1/2025:

Maturity	Coupon	Yield	+/- AAA 5%
2020	3.00	1.65	+16
2025	3.00	2.45	+9
2034	3.50	3.59	+54

Notes: These types of water-related issuances are increasing

FARWEST

6/18: The **Washington Unified School District, CA** sold $24.9 million general obligation bonds to **Bank of America Merrill Lynch**; A2/AA/NR; callable at par in 8/1/2024:

Maturity	Coupon	Yield	+/- AAA 5%
2020	4.00	1.75	+27
2025	4.00	2.74	+40
2035	4.00	3.81	+73

Notes: The school district locked in 4% coupons across the board