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Credit Enhancement: Letter of Credit & Bond Insurance Options

The Broadcast will Begin at 8:45am EDT

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Hello! Welcome to the webcast.

Katie Kramer

Director, Education & Programs
Council of Development Finance Agencies
Columbus, OH

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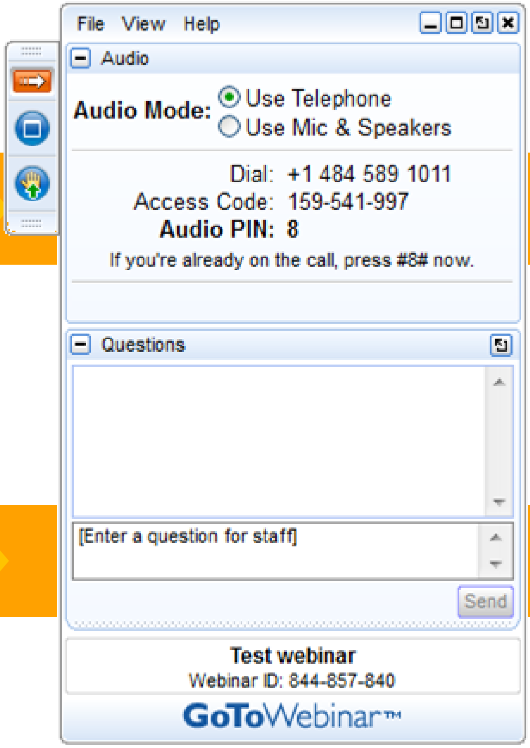

Panelists

Tony Portuondo, *Moderator*
BNY Mellon

Steve Eikenberry
First American Bank

Scott Richbourg
Build America Mutual

Chris Chafizadeh
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Tony Portuondo

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BNY MELLON

MUNICIPAL BOND MARKET

JULY 30, 2013

TRENDS IN BOND ENHANCEMENT

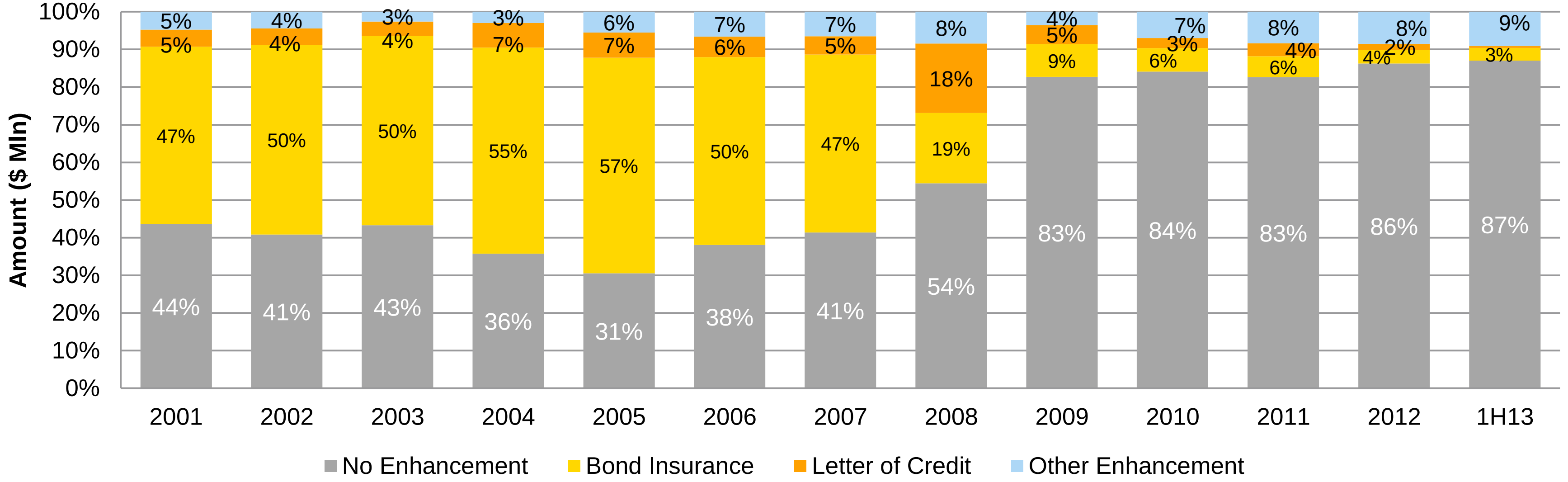
Long Term Market Trends

Top Bond Enhancers

Market Outlook

Municipal Market Bond Enhancement Trends

Bond Enhancement As Percent of Entire New Issue Market



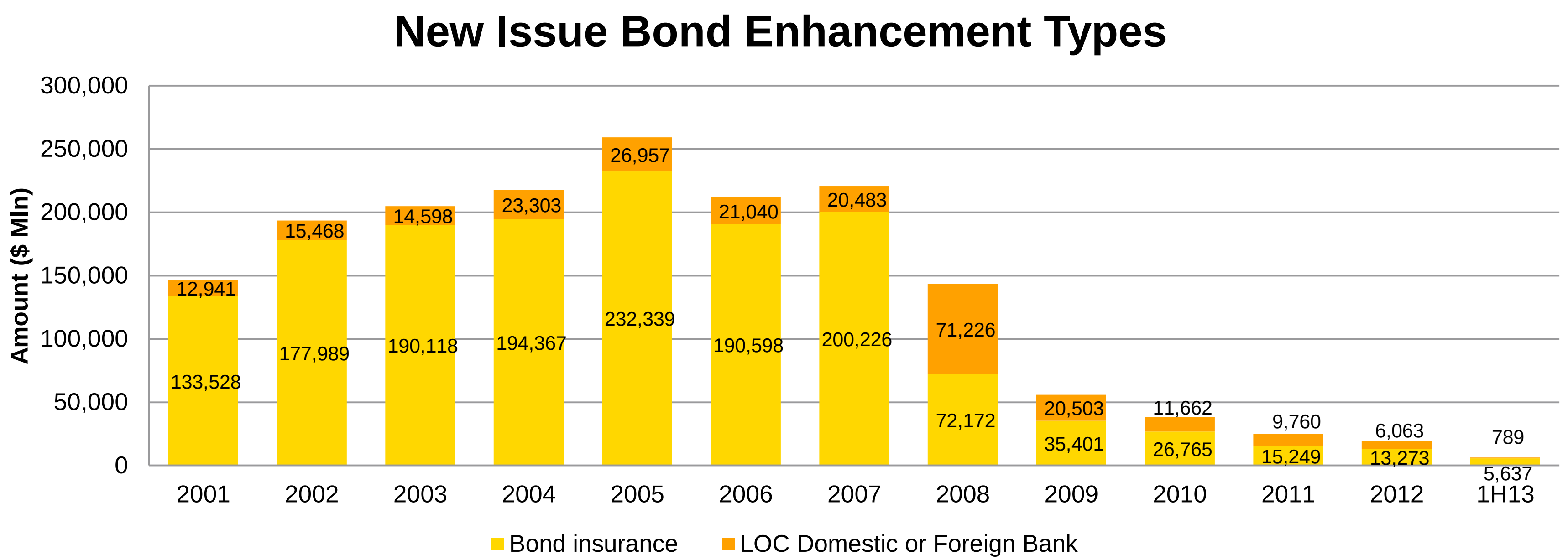
BOND ENHANCEMENT PEAKED IN 2005 WHEN 69% OF THE MARKET INCLUDED SOME FORM OF ENHANCEMENT.

BOND INSURANCE ACCOUNTED FOR 82% OF ALL ENHANCEMENT IN 2005, VS 26% FOR 1H2013, AND SAW A VOLUME DECLINE 0F 96% IN THAT PERIOD

LETTER OF CREDIT ENHANCEMENT PEAKED IN 2008, WITH $71 BLN IN NEW ISSUES

Data Source: Thomson Reuters as of June 30, 2013

Municipal Market New Issue Trends



BOND INSURANCE HAS SEEN A VOLUME DECLINE 0F 96% FROM 2005 TO 2012

FOREIGN BANKS TYPICALLY PROVIDE 35% OF THE LOC ACTIVITY, BUT PROVIDED 36% OF THE MARKET IN 2012.

Data Source: Thomson Reuters as of June 30, 2013

Top Bond Enhancers in 2012-1H2013 Municipal Debt Market

Bond Enhancers	Principal Amount ($ mln)	Rank	Mkt Shr (%)	# of issues
AGM formerly FSA Inc	16,634.2	1	3.1	1429
Permanent School Fund	12,220.2	2	2.3	527
Michigan Sch Bond Qual & Loan	2,604.6	3	.5	151
Washington SD Enhanced Program	2,501.8	4	.5	104
Colorado Intercept Program	2,162.1	5	.4	70
Build America Mutual (BAM)	2,154.8	6	.4	294
Minnesota SD Enhanced Program	1,813.0	7	.3	186
New Jersey School Bond Reserve	1,662.5	8	.3	140
Indiana Intercept Program	1,492.3	9	.3	152
Issuer	1,340.7	10	.3	10
Industry Total	**537,160.8**	**-**	**100.0**	**18,664**

TOP ENHANCER AGM IS THE TOP BOND INSURANCE PROVIDER, WHILE PERMANENT SCHOOL FUND GUARANTEES TEXAS EDUCATION BONDS.

THESE TWO ACCOUNT FOR 40% OF ALL ENHANCEMENT IN 2012-1H13

Data Source: Thomson Reuters as of June 30, 2013

Bond Enhancers by Type of Enhancement 2012-1H2013

Guaranteed Enhancers	Principal Amount ($ mln)	Rank	Mkt Shr (%)	# of issues
Permanent School Fund	12,220.2	1	28.9	527
Michigan Sch Bond Qual & Loan	2,590.5	2	6.1	150
Washington SD Enhanced Progra	2,501.8	3	5.9	104
Colorado Intercept Program	2,162.1	4	5.1	70
Minnesota SD Enhanced Program	1,813.0	5	4.3	186
Industry Total	**42,236.0**	**-**	**100.0**	**2,533**

Bond insurance Enhancers	Principal Amount ($ mln)	Rank	Mkt Shr (%)	# of issues
AGM formerly FSA Inc	16,634.2	1	49.1	1429
Build America Mutual (BAM)	2,154.8	2	6.4	294
Berkshire Hathaway Assurance	106.9	3	.3	1
Assured Guaranty	13.7	4	.0	2
Industry Total	**33,870.5**	**-**	**100.0**	**1,726**

LOC Domestic Bank Enhancers	Principal Amount ($ mln)	Rank	Mkt Shr (%)	# of issues
Wells Fargo Bank	830.4	1	17.5	13
Citibank	695.0	2	14.6	4
PNC Bank NA	576.4	3	12.1	11
US Bank NA	543.7	4	11.4	10
J P Morgan Chase	529.9	5	11.1	7
Industry Total	**4,756.8**	**-**	**100.0**	**96**

Mortgage backed Enhancers	Principal Amount ($ mln)	Rank	Mkt Shr (%)	# of issues
GNMA	1,263.3	1	60.4	30
FNMA	1,157.2	2	55.3	32
Federal Home Loan Mtg Corp	674.4	3	32.2	30
Cal-Mortgage - Hlth Fac Constr	355.4	4	17.0	11
FHA	56.8	5	2.7	5
Industry Total	**2,091.9**	**-**	**100.0**	**74**

Standby Purch Agreement Enhancers	Principal Amount ($ mln)	Rank	Mkt Shr (%)	# of issues
Bank of America	324.4	1	12.5	2
Wells Fargo Bank	317.0	2	12.3	5
State Street Bank & Trust Co	300.0	3	11.6	4
The Bank of New York Mellon	220.5	4	8.5	3
Bank of Tokyo-Mitsubishi UFJ	216.0	5	8.4	3
Industry Total	**2,586.7**	**-**	**100.0**	**30**

MOST ENHANCEMENT TYPES ARE SUPPORTED BY 1-2 TOP ENTITIES, EXCEPT FOR LOCS WHICH ARE FAIRLY EVENLY DISTRIBUTED ACROSS THE TOP US BANKS.

Data Source: Thomson Reuters as of June 30, 2013

Steve Eikenberry

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Credit Enhancement:
Letter of Credit & Bond Insurance Options

- **Introduction**
- **Credit Enhancement Options**
- **The Current Market**

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The financial crisis dramatically changed the credit enhancement landscape.

- Since 2008, issuers have had few options for credit enhancement.
- Prior to the financial crisis, bond insurance penetration exceeded 50% of the total market. Letters of credit accounted for only about 5%.
- In 2008, bond insurance declined to just over 10%, while letters of credit increased to around 18% as many borrowers restructured their auction rate securities.
- By 2012, bond insurance had sunk to just 3.6% of the market, while letters of credit had declined back down to below 4%.
- The decline in L/C enhancement is due to credit stress and capital constraints at the larger banks, combined with downgrades of many regional bank providers.
- Many new issues are being sold as private placements without credit enhancement.

Bond Insurance

- No renewal risk
- Primarily fixed rate – not a liquidity facility
- Supports long-term fixed rates
- Typically available only for better quality borrowers
- Not subject to put risk
- Subject to arbitrage costs during construction period
- Upfront fee can be financed, but is sunk cost in the event of a refinancing
- In borrower default insurer continues to make payments

Letters of Credit

- Typically 3-5 year term
- Primarily floating rate
- Subject to renewal risk at end of commitment
- Subject to put risk based on credit of bank or market demand
- In borrower default, bonds are called and paid off by bank
- Fee paid annually in advance
- Swap or other hedge allows for synthetic fixed rate
- Pricing may increase or decrease at renewal
- May allow for more flexible covenant package

Private Placement

- Most advantageous for smaller transactions
- Typically 3-5 year term
- Fixed or floating rate only for term of commitment
- Multiple disbursements eliminate arbitrage costs
- Reduced documentation costs
- Investor demand subject to TEFRA disallowance and AMT
- Subject to renewal risk at end of commitment
- Pricing may increase or decrease at renewal
- Not subject to put risk from investors
- May allow for more flexible covenant package

- Uncertainty related to Dodd Frank and Basel III capital requirements have reduced bank's appetites for letters of credit. In addition, banks have been reluctant to extend maturities beyond three years.
- Proposed capital rules appear to have a greater effect on the largest banks that provide the overwhelming majority of L/C enhancement.
- Low levels of interest rates have minimized the TEFRA penalty for non-bank qualified bonds, allowing more privately placed issues to be priced competitively.
- Over the last three years at the Illinois Finance Authority, only 18% of private activity bonds were L/C backed, while 75% were unenhanced private placements. Ten years ago, these percentages would have been reversed.
- Future uncertainty relating to changes in the tax code may limit bank's appetites for purchasing tax exempt debt, or reduce the term of their commitment.
- Recently, auditors have begun calling attention to bond issues where the bank commitment expires in under one year, either classifying the debt as current, or noting the risk in a footnote.

Scott Richbourg

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Managing Director
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Overview

- Why Municipal Bond Insurance?
- Issuers and Investors Benefit (A Win-Win)
- Economics of Bond Insurance – Issuer Savings
- Insurance Market Overview
- Active Insurers in the Market

Why Bond Insurance?

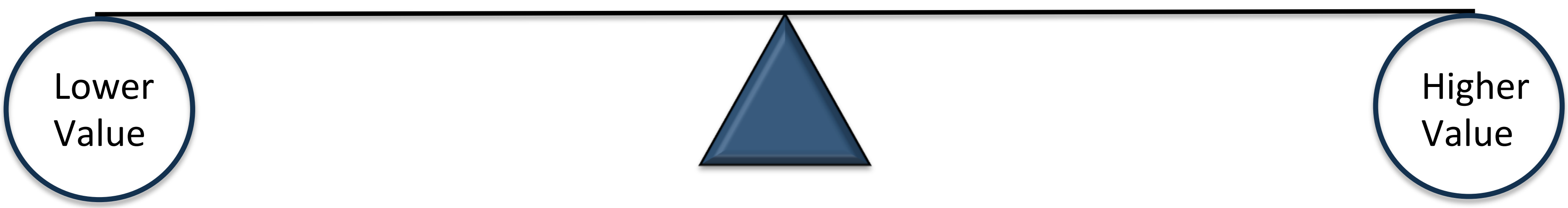
- Municipal market is very different from corporate model
- Over 50,000 issuers of municipal bonds
- Less than 1,000 Corporate issuers
- Municipal issuers tend to be lesser known and less liquid
- Relatively speaking the municipal market is not very efficient
- Comparison with Corporate Market
  - Number of issuers
  - Complexity of security
  - Serial vs. Term
  - Call features
  - Availability and timeliness of information
  - Higher trading costs

Market Conditions Affect Value of Bond Insurance

- Interest rates and general credit concerns impact insurance value

- Stable Interest Rates
- Low Credit Risk

- Volatile Interest Rates
- Heightened Credit Risk



Market is moving to a higher, more volatile interest rate environment with increasing credit risk concerns

Benefits of Bond Insurance (A Win-Win)

- **Issuer Benefits:**
  - A lower cost of capital – interest rate savings
  - Broadened distribution (institutional & retail)
  - A simplified credit story for complex bond issues
  - Effective marketing for small, lesser known names
  - Greater access to the capital markets
  - Certainty of Execution

- **Investor Benefits:**
  - Unconditional protection against issuer default
  - Superior credit selection
  - Greater price stability
  - Enhanced liquidity for secondary market trading
  - Simplified risk assessment
  - Dual events prior to a loss (underlying & insurer have to fail)
  - Surveillance & if necessary, Remediation

Bond Insurance Economics

Insured vs. Uninsured Bonds Trading Benefit*							
	AA-	**A+**	**A**	**A-**	**BBB+**	**BBB**	**BBB-**
General Obligation	6	12	15	20	25	35	50
Revenue Bonds	5	10	12	17	20	25	40

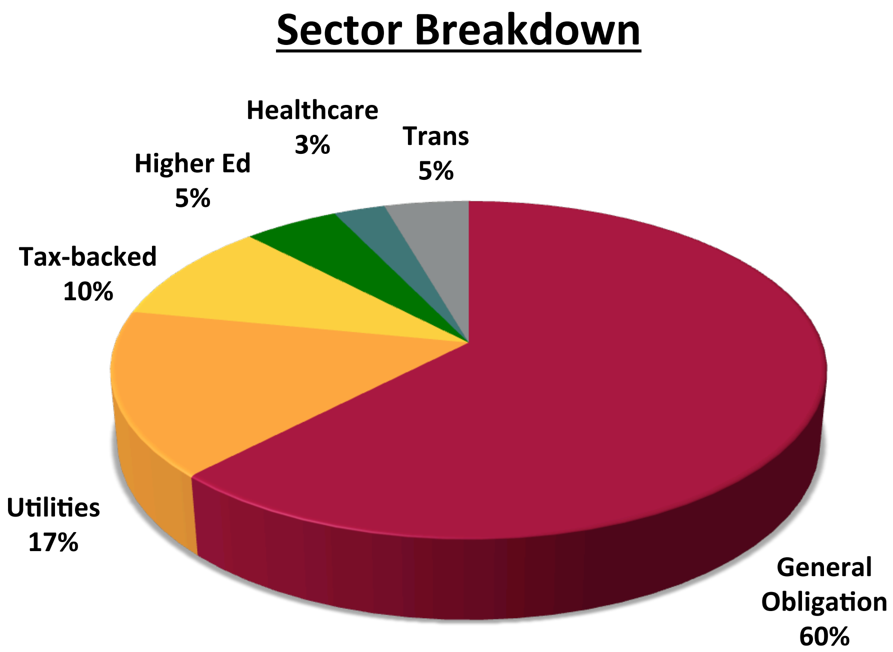
- **Insurance Premiums approximate 50% of trading benefit**

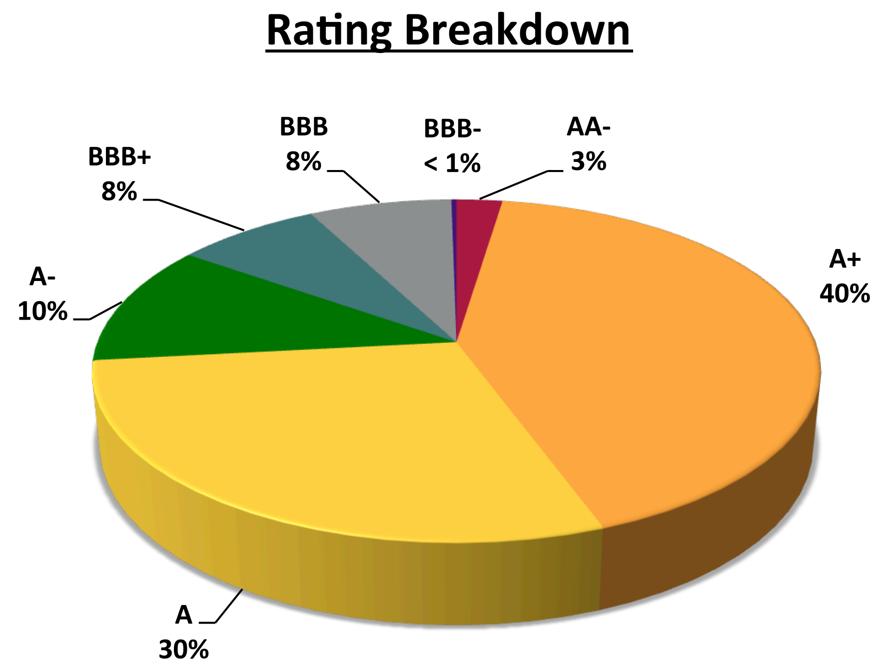
Estimated Net Issuer Savings = 1% of Par

YTD, bond insurance has saved municipal issuers over $50 million in interest costs

*Trading values vary based upon insurer, underlying sector and rating

Insurance Market Overview





- Average rating of “A” category.
- Average deal size = $10 million to $50 million
- Current Insurance Penetration = 3-5% of Par and 7-10% of Issuers
- Target Insurance Market = 20-30% of overall market

Insurers: Better than Before

- **Currently Active Insurers are Better than Before:**
  - Insure only Municipal Bonds
  - Focus on the Safer Municipal Sectors
  - Lower Leverage
  - Smaller single risk exposures
  - Primarily fixed rate bonds

Current Insurers are more conservative and offer greater value to issuers and investors

Active Insurers

Assured Guaranty

- AGM (AA- S&P/A2 Moody's)
- MAC (AA- S&P/AA+ Kroll)

Build America Mutual

- BAM (AA S&P)

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Daily: 12-5pm EDT

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- Tuesday, September 17 @ 1:00 pm EDT

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