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Sequestration & the Fiscal Cliff

Erin Tehan

Legislative & Federal Affairs Coordinator
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Columbus, OH

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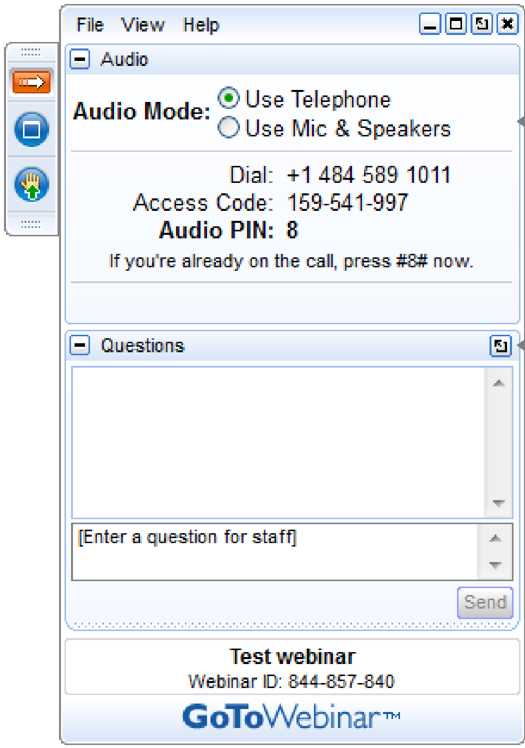
Sequestration & the Fiscal Cliff



Using your telephone will give you better audio quality.

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Sequestration & the Fiscal Cliff

Speakers

Andrew Flynn, *Moderator*
BNY Mellon

Tom Kozlik
Janney Montgomery Scott, LLC

Lew Feldman
Goodwin Procter LLP

Eileen Fahey
Fitch Ratings

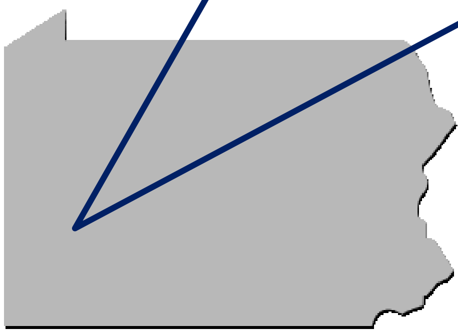
Sarah Repucci
Fitch Ratings

CDFA - BNY Mellon
Development Finance
Webcast Series

Sequestration & the Fiscal Cliff

Andrew Flynn

Managing Director
BNY Mellon
Pittsburgh, PA



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20 November 2012

Sequestration and the Fiscal Cliff: an Introduction

CDFA-BNYM Webcast

Presented by Andrew R. Flynn

Introduction

- What is the Fiscal Cliff?

The Fiscal Cliff is a new term popularized by Federal Chairman Ben Bernanke referring to the effect of a number of laws which (if left unchanged) could result in spending cuts, tax increases, and a corresponding reduction in the budget deficit beginning in 2013. These laws include tax increases due to the expiration of the Bush tax cuts and spending cuts under the Budget Control Act of 2011.

2001
Economic Growth and Tax Relief Reconciliation Act of 2001

2003
Jobs and Growth Tax Relief Reconciliation Act of 2003

December 2010
Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

August 2011
Budget Control Act of 2011

August 2012
Sequestration Transparency Act of 2012

September 2012
Obama released his 400-page document detailing cuts

October 2012
At the third of three presidential debates, Obama says sequestration will not happen

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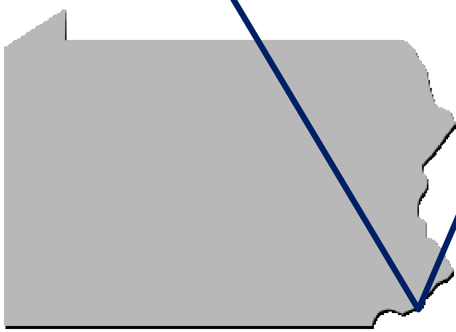
Sequestration & the Fiscal Cliff

Tom Kozlik

Director

Janney Montgomery Scott LLC

Philadelphia, PA



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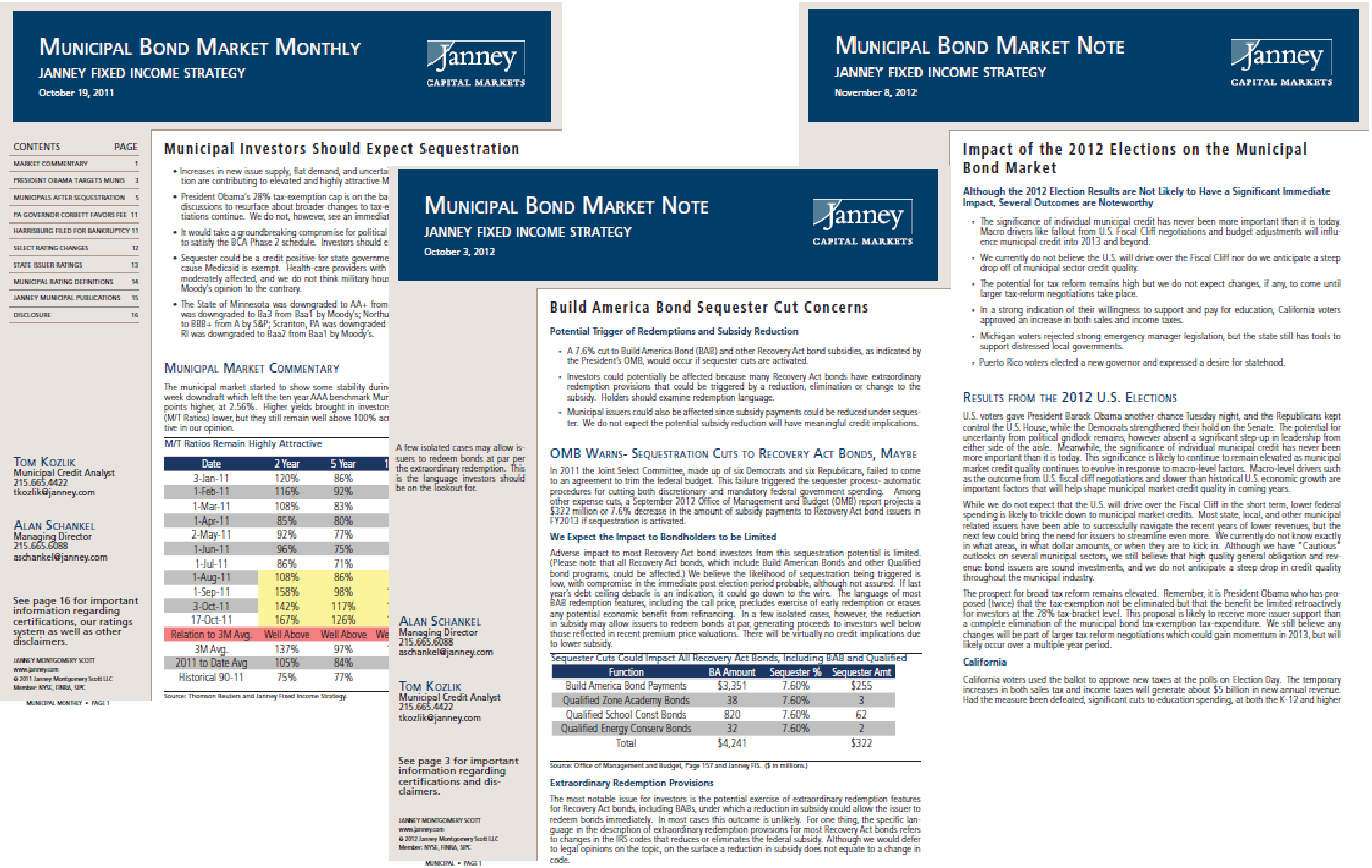
MUNICIPAL BOND MARKET MONTHLY
JANNEY FIXED INCOME STRATEGY
October 19, 2011
Janney CAPITAL MARKETS

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Municipal Investors Should Expect Sequestration

- Increases in new issue supply, flat demand, and uncertai... tion are contributing to elevated and highly attractive M...
- President Obama's 28% tax-exemption cap is on the ba... discussions to resurface about broader changes to tax-e... tiations continue. We do not, however, see an immediat...
- It would take a groundbreaking compromise for political... to satisfy the BCA Phase 2 schedule. Investors should e...
- Sequester could be a credit positive for state governme... cause Medicaid is exempt. Health-care providers with... moderately affected, and we do not think military hous... Moody's opinion to the contrary.
- The State of Minnesota was downgraded to AA+ from... was downgraded to Ba3 from Baa1 by Moody's; Northu... to BBB+ from A by S&P; Scranton, PA was downgraded t... RI was downgraded to Baa2 from Baa1 by Moody's.

MUNICIPAL MARKET COMMENTARY

The municipal market started to show some stability durin... week downdraft which left the ten year AAA benchmark Mun... points higher, at 2.56%. Higher yields brought in investors... (M/T Ratios) lower, but they still remain well above 100% acr... tive in our opinion.

M/T Ratios Remain Highly Attractive

Date	2 Year	5 Year
3-Jan-11	120%	86%
1-Feb-11	116%	92%
1-Mar-11	108%	83%
1-Apr-11	85%	80%
2-May-11	92%	77%
1-Jun-11	96%	75%
1-Jul-11	86%	71%
1-Aug-11	108%	86%
1-Sep-11	158%	98%
3-Oct-11	142%	117%
17-Oct-11	167%	126%
Relation to 3M Avg.	Well Above	Well Above
3M Avg.	137%	97%
2011 to Date Avg	105%	84%
Historical 90-11	75%	77%

Source: Thomson Reuters and Janney Fixed Income Strategy.

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MUNICIPAL MONTHLY • PAGE 1

MUNICIPAL BOND MARKET NOTE
JANNEY FIXED INCOME STRATEGY
October 3, 2012
Janney CAPITAL MARKETS

Build America Bond Sequester Cut Concerns

Potential Trigger of Redemptions and Subsidy Reduction

- A 7.6% cut to Build America Bond (BAB) and other Recovery Act bond subsidies, as indicated by the President's OMB, would occur if sequester cuts are activated.
- Investors could potentially be affected because many Recovery Act bonds have extraordinary redemption provisions that could be triggered by a reduction, elimination or change to the subsidy. Holders should examine redemption language.
- Municipal issuers could also be affected since subsidy payments could be reduced under sequester. We do not expect the potential subsidy reduction will have meaningful credit implications.

OMB WARNS- SEQUESTRATION CUTS TO RECOVERY ACT BONDS, MAYBE

In 2011 the Joint Select Committee, made up of six Democrats and six Republicans, failed to come to an agreement to trim the federal budget. This failure triggered the sequester process- automatic procedures for cutting both discretionary and mandatory federal government spending. Among other expense cuts, a September 2012 Office of Management and Budget (OMB) report projects a $322 million or 7.6% decrease in the amount of subsidy payments to Recovery Act bond issuers in FY2013 if sequestration is activated.

We Expect the Impact to Bondholders to be Limited

Adverse impact to most Recovery Act bond investors from this sequestration potential is limited. (Please note that all Recovery Act bonds, which include Build American Bonds and other Qualified bond programs, could be affected.) We believe the likelihood of sequestration being triggered is low, with compromise in the immediate post election period probable, although not assured. If last year's debt ceiling debacle is an indication, it could go down to the wire. The language of most BAB redemption features, including the call price, precludes exercise of early redemption or erases any potential economic benefit from refinancing. In a few isolated cases, however, the reduction in subsidy may allow issuers to redeem bonds at par, generating proceeds to investors well below those reflected in recent premium price valuations. There will be virtually no credit implications due to lower subsidy.

A few isolated cases may allow issuers to redeem bonds at par per the extraordinary redemption. This is the language investors should be on the lookout for.

Sequester Cuts Could Impact All Recovery Act Bonds, Including BAB and Qualified

Function	BA Amount	Sequester %	Sequester Amt
Build America Bond Payments	$3,351	7.60%	$255
Qualified Zone Academy Bonds	38	7.60%	3
Qualified School Const Bonds	820	7.60%	62
Qualified Energy Conserv Bonds	32	7.60%	2
Total	$4,241		$322

Source: Office of Management and Budget, Page 157 and Janney FIS. ($ in millions.)

Extraordinary Redemption Provisions

The most notable issue for investors is the potential exercise of extraordinary redemption features for Recovery Act bonds, including BABs, under which a reduction in subsidy could allow the issuer to redeem bonds immediately. In most cases this outcome is unlikely. For one thing, the specific language in the description of extraordinary redemption provisions for most Recovery Act bonds refers to changes in the IRS codes that reduces or eliminates the federal subsidy. Although we would defer to legal opinions on the topic, on the surface a reduction in subsidy does not equate to a change in code.

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MUNICIPAL • PAGE 1

MUNICIPAL BOND MARKET NOTE
JANNEY FIXED INCOME STRATEGY
November 8, 2012
Janney CAPITAL MARKETS

Impact of the 2012 Elections on the Municipal Bond Market

Although the 2012 Election Results are Not Likely to Have a Significant Immediate Impact, Several Outcomes are Noteworthy

- The significance of individual municipal credit has never been more important than it is today. Macro drivers like fallout from U.S. Fiscal Cliff negotiations and budget adjustments will influence municipal credit into 2013 and beyond.
- We currently do not believe the U.S. will drive over the Fiscal Cliff nor do we anticipate a steep drop off of municipal sector credit quality.
- The potential for tax reform remains high but we do not expect changes, if any, to come until larger tax-reform negotiations take place.
- In a strong indication of their willingness to support and pay for education, California voters approved an increase in both sales and income taxes.
- Michigan voters rejected strong emergency manager legislation, but the state still has tools to support distressed local governments.
- Puerto Rico voters elected a new governor and expressed a desire for statehood.

RESULTS FROM THE 2012 U.S. ELECTIONS

U.S. voters gave President Barack Obama another chance Tuesday night, and the Republicans kept control the U.S. House, while the Democrats strengthened their hold on the Senate. The potential for uncertainty from political gridlock remains, however absent a significant step-up in leadership from either side of the aisle. Meanwhile, the significance of individual municipal credit has never been more important than it is today. This significance is likely to continue to remain elevated as municipal market credit quality continues to evolve in response to macro-level factors. Macro-level drivers such as the outcome from U.S. fiscal cliff negotiations and slower than historical U.S. economic growth are important factors that will help shape municipal market credit quality in coming years.

While we do not expect that the U.S. will drive over the Fiscal Cliff in the short term, lower federal spending is likely to trickle down to municipal market credits. Most state, local, and other municipal related issuers have been able to successfully navigate the recent years of lower revenues, but the next few could bring the need for issuers to streamline even more. We currently do not know exactly in what areas, in what dollar amounts, or when they are to kick in. Although we have "Cautious" outlooks on several municipal sectors, we still believe that high quality general obligation and revenue bond issuers are sound investments, and we do not anticipate a steep drop in credit quality throughout the municipal industry.

The prospect for broad tax reform remains elevated. Remember, it is President Obama who has proposed (twice) that the tax-exemption not be eliminated but that the benefit be limited retroactively for investors at the 28% tax-bracket level. This proposal is likely to receive more issuer support than a complete elimination of the municipal bond tax-exemption tax-expenditure. We still believe any changes will be part of larger tax reform negotiations which could gain momentum in 2013, but will likely occur over a multiple year period.

California

California voters used the ballot to approve new taxes at the polls on Election Day. The temporary increases in both sales tax and income taxes will generate about $5 billion in new annual revenue. Had the measure been defeated, significant cuts to education spending, at both the K-12 and higher

Janney CAPITAL MARKETS

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Sequestration & the Fiscal Cliff

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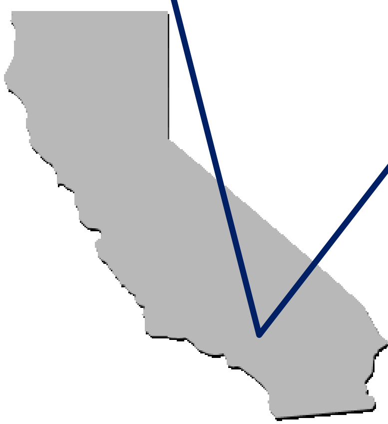

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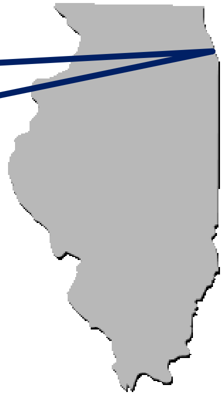

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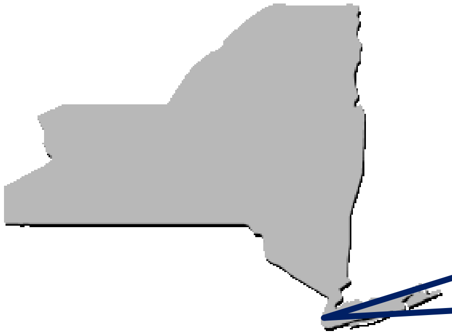
Chicago, IL



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US Fiscal Cliff Risks Impact on BAB Bonds

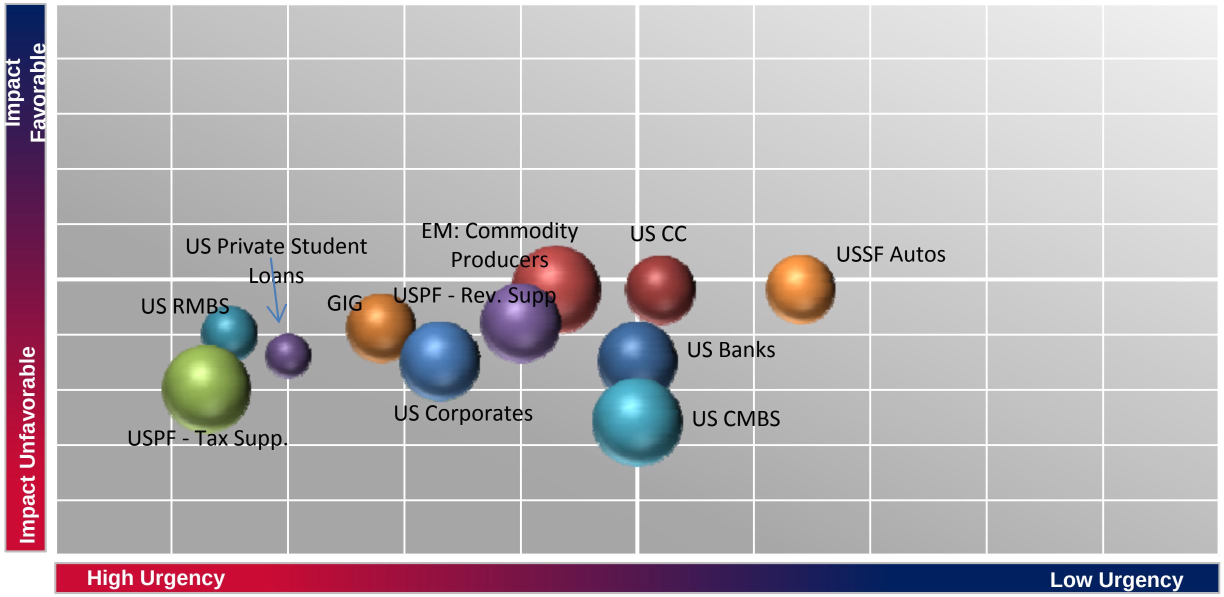
Eileen Fahey, Regional Credit Officer Americas

Sarah Repucci, Group Credit Officer USPF

November 20, 2012

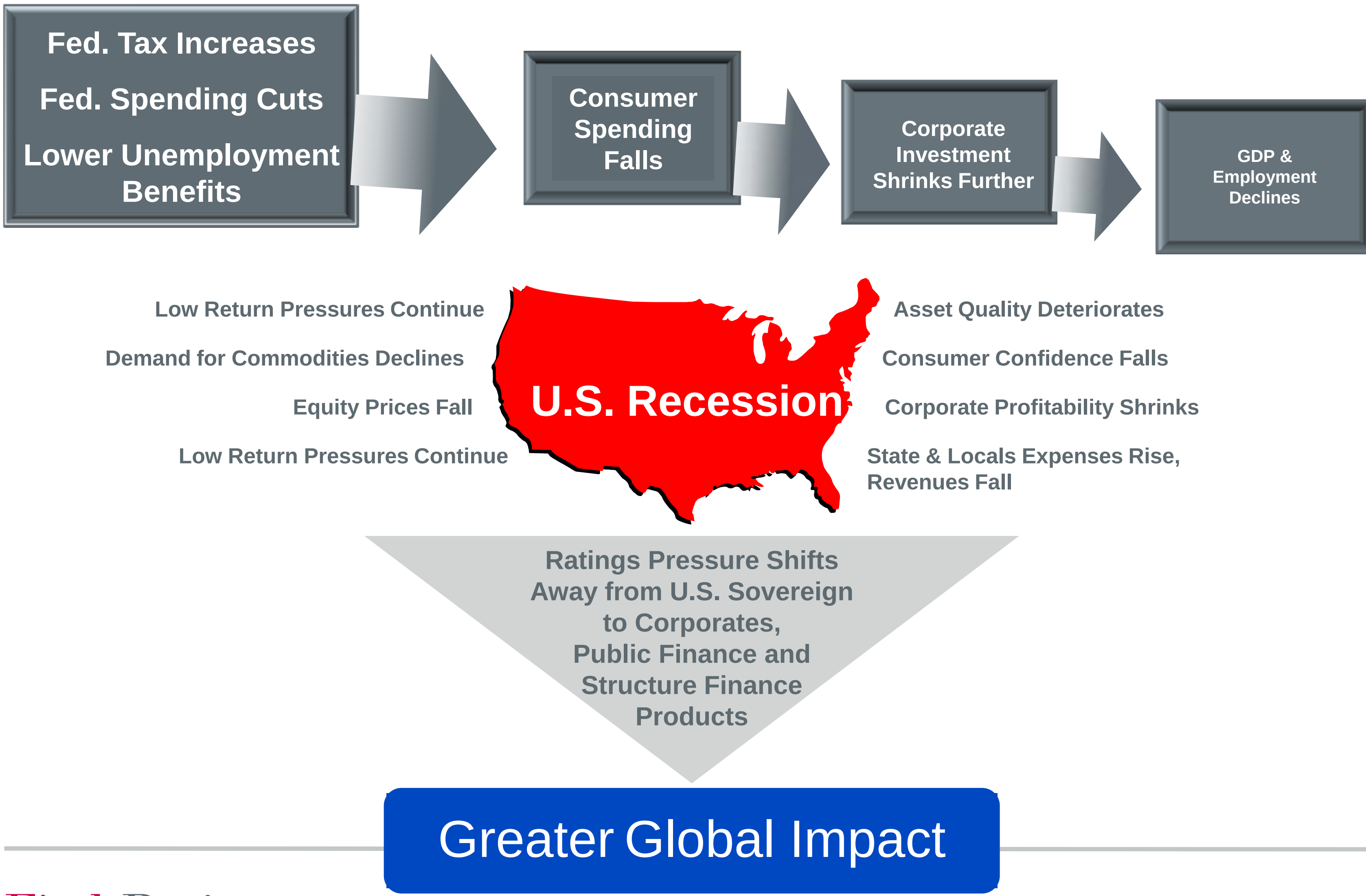
Fitch Base Case

U.S. Economy: Slow Recovery Continues



- Base Case: Unemployment remains high for next 2 years, low growth in GDP
- Ratings pressure on local and regional governments as labor pressures continue with limited budget flexibility
- Ratings impact relative to current ratings levels: Not seen as significant change in ratings
- Size indicates number of issues, which in this sector quite large

U.S. Fiscal Cliff



FitchRatings

BABs and Sequestration

- Fitch's ratings base case calculates debt service coverage without the subsidy. Ratings on the BABs and parity debt reflect net coverage.
- Loss of subsidy is not expected to negatively affect credit for the vast majority.
- Subsidy considered an addition to revenue in analysis.

BABs and Sequestration

- For Fitch rated issues, most BABs and parity debt have cushion to absorb the subsidy reduction and will maintain debt service coverage consistent with the rating.
- Small number of special tax BABs with already slim debt service coverage would see their margins reduced to levels that put negative pressure on the rating.
- Fitch expects that issuers will show a tightening in coverage, and then modify their budgets to accommodate the subsidy reduction.

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Daily: 12-5pm (EST)
January 29-30, 2013

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February 13, 2013

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Next Webcast

CDFA – Stifel Nicolaus Tax Increment Finance Webcast Series
Thursday, December 6, 2012 @ 1:00pm Eastern

CDFA – BNY Mellon Development Finance Webcast Series
Tuesday, December 28, 2012 @ 1:00pm Eastern

More information on webcasts in 2013 – coming soon

For More Information

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