CDFA – BNY Mellon Development Finance Webcast Series: Municipal Bonds Mayhem & Mystery - What to Expect in 2013

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February-May, 2013
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cdfa Council of Development Finance Agencies
March 14-15, 2013
Washington, DC

CDFA - BNY Mellon Development Finance Webcast Series

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Municipal Bonds Mayhem & Mystery

Erin Tehan

Legislative & Federal Affairs Coordinator
Council of Development Finance Agencies
Columbus, OH

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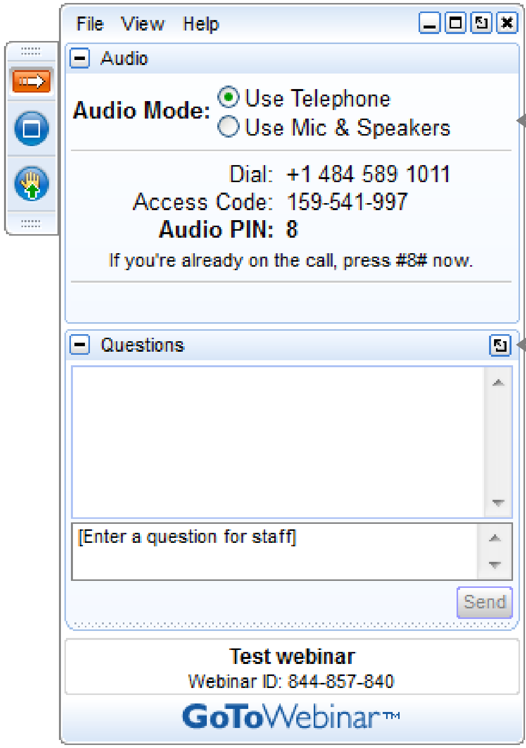
Municipal Bonds Mayhem & Mystery



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CDFA - BNY Mellon Development Finance Webcast Series

cdfa Council of Development Finance Agencies

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Speakers

Christine Johnson, *Moderator*
BNY Mellon

Natalie Cohen
Wells Fargo Securities

Greg Usry
Rosemawr Management

Eric Silva
Winston & Strawn

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Intro Public-Private Partnership (P3) Finance Course
August 6-7, 2013
Washington, DC

in partnership with IIUSA Association to Invest in USA
Intro EB-5 Finance WebCourse
September 18-19, 2013
Daily: 12-5pm (EDT)

Municipal Bonds Mayhem & Mystery

Christine Johnson

Product Manager
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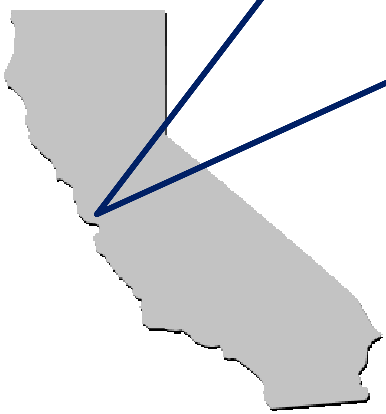

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CORPORATE TRUST

January 15, 2013

Municipal Bond Market Outlook - 2013

CDFA-BNYM Webcast

Presented by Christine Johnson

Municipal Bonds in 2012

- Issuance was steady to slightly up.
- Default rates remained low- even for high-yield muni debt (in comparison to corporate bonds).
- Municipal bankruptcies in California (Stockton and San Bernardino) brought the obligation to pay debt into focus.

How will we see an impact in 2013?

- A number of regulatory and other impacts could affect the muni market this year.
  - Progress on tax reform talks with interest deduction caps, elimination of tax exemption still outstanding.
    - Will we see resurgence of taxable muni debt?
    - Impact of tax changes to personal income.
  - International regulation changes, i.e. Basel III.
  - Increased attention on P3 could bring more investment to US infrastructure.
  - Recovering tax revenue in certain regions impacting issuance.
  - Further regulation with unintended impacts?
  - Discussions around disclosure becoming regulation (especially around private placements).
  - Disaster bonds?
  - Underfunded state/local entitlement programs (pensions, health care).

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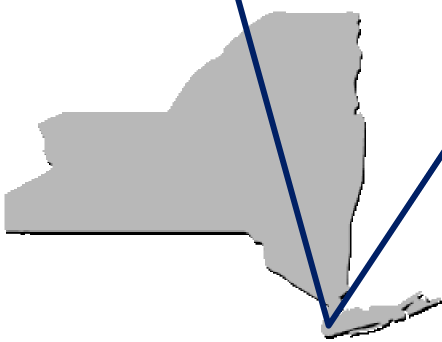
Municipal Bonds Mayhem & Mystery

Natalie Cohen

Managing Director
Wells Fargo Securities
New York, NY



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WELLS FARGO SECURITIES

Municipal Bonds, Mayhem and Mystery: What to Expect in 2013

Natalie Cohen
Head of Municipal Research
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212-214-8014

January 15, 2013

Please see the disclosure appendix of this publication
for certification and disclosure information

First, a few Municipal Market Themes

- ***Moving from the "cliff" to talking Congress off the "ledge"***
  - Debt ceiling debates likely to be rocky and risk further US downgrade
    - Some Republicans favor default and/or government shutdown in order to force cuts
  - March 1 sequestration deadline (current sequestration plan in effect until changed)
  - March 27 government continuing resolution must be extended
- ***Investors (across the board) are highly reactive: "risk-on, risk-off"; "buy on hope, sell on the facts"***
- ***Some municipal market deleveraging taking place***
  - *C*alls and repayments are not being replaced with new issue
  - The leading edge of the high volume period began in 2002 and will continue for another seven-eight years; those bonds are now callable
- ***Federal Reserve Interventions Influence Market***
  - QE1, QE2, Twist
  - Twelve years + of managed low interest rates and a difficult stock market has hurt pensions, endowments – feeding back into higher state/local costs.

Federal Themes in 2013 Q1

- ***What was recently resolved: the American Taxpayer Relief Act of 2012***
  - End of payroll holiday affects virtually all workers (+2%)
  - Higher tax rates --39.6%-- lets Bush tax cuts expire and return to the highest bracket but only for earners =>$400,000 (individual); =>$450,000 (married, filing jointly); makes tax exempt
  - At lower earnings levels, Bush tax cuts were made permanent (e.g. 25%, 28% and 33% brackets rather than 28%, 31% and 36%)
  - AMT made permanent – a good outcome for AMT borrowers
  - New bracket for capital gains: from 15% to 20%
  - Permanent tax changes a help towards eliminating uncertainty, but much more is to be done
  - Personal exemptions phase-out
  - "PEASE" reduces the value of certain deductions by 3% (but cannot exceed 80% of the value of deductions); Does not apply to medical expenses, investment interest or casualty and theft losses; also does not apply for AMT calculation

What wasn't resolved: Sequestration

- If it comes to it, $1.2 trillion automatic reductions are spread across 10 years, with half coming from defense and half from non-defense with both "discretionary" and "direct" programs affected.
- "Discretionary" programs are those funded with appropriation bills by Congress
- "Direct" programs are those that already have statutory eligibility and payment formulas in place such as Social Security, Medicare, Veteran's benefits and Medicaid (aka "entitlements")
- ***Mandatory Programs Not Subject to Sequestration***
    - Social Security
    - Most Unemployment Benefits
    - Veteran's benefits
    - Interest on the debt
    - Federal Retirement
    - Low income entitlements such as Medicaid, SNAP (food stamps) and Supplemental Security Income

Subject to Sequestration – based on the Sequestration Transparency Act Report Issued by OMB

- Mandatory Programs Subject to Sequestration
  - Most Medicare payments (but capped at 2%)
  - Farm price supports
  - Vocational Rehabilitation Basic State Grants
  - Mineral leasing payments to states
  - Social Services block grants
  - IRS related programs
    - Build America Bond subsidy ($255 million cut) ***Note to investors***: check call provisions; a cut from the 35% subsidy ***may*** trigger calls.
    - Qualified School Construction Bonds ($62 million cut)
  - Other
    - FEMA
    - Homeland Security
    - Federal payments to state and local governments "in lieu of taxes" ("PILOT" payments-- for state and local government services provided on federal land)
    - Federal Aviation Administration
    - Federal Highway Administration

State/local thoughts heading into 2013

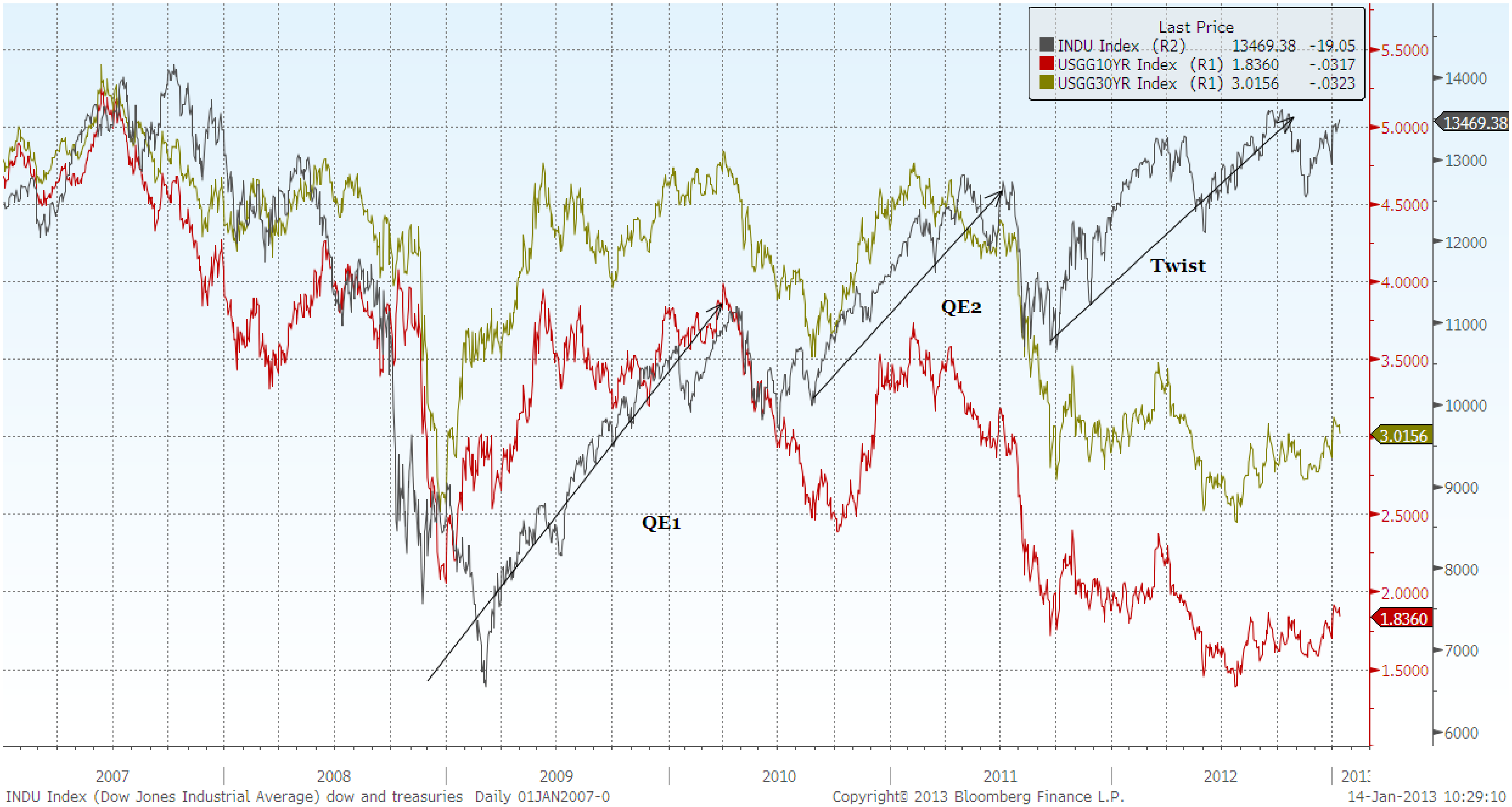
- ***State/local Behavior Is Not The Same As At The Federal Level***
  - We believe the muni market is ahead of the federal government, in some respects:
    - balanced budgets are required (albeit not without some gimmickry)
    - tax increases were approved in some places
    - pension changes are increasing
    - some state and local governments are innovating with technology
    - knowledgeable investors are beginning to recognize this value.
- ***Local Credit Concerns***
  - "Trickle down" of fiscal stress will still continue to hit school districts, counties, cities and towns in 2013, and states are not completely out of the woods either;
    - Some federal action likely to really be a "cost shift" to the state/local level;
      - Healthcare is potentially the big one here, particularly Medicaid and particularly for counties
    - Unfunded pension and retiree health benefits continue to exert pressure; gaining greater visibility with taxpayers
  - Bankruptcy worries

Then there's the question of tax exemption

- May be taken up as a potential source of "revenue" in contrast with "tax increase". Tax exemption considered a "tax expenditure" – key Democrat concept
- But full tax reform not likely to take place (if at all) until H2 2013
- The biggest flaw in Congressional analysis: ***investors don't stand still!***
- ***Elimination***
  - ***Likely to be prospective; retroactivity would be extremely disruptive to the market – Packwood proposal in 1980's halted market completely***
    - ***Would likely create a bifurcated market; outstanding tax exempts would become very valuable***
    - ***What we learned from Build America Bond program (BAB's): corporate investors want/expect timely reporting; and liquidity; smaller issuers would likely revert to private placement/ bank model***
- ***Re-visit BAB's***
  - ***Likely to have much lower federal subsidy than previously (more like 28% than 35%); one proposal is for 15%. If tax-exemption survives as well there could be curve distortions like last time (BABs at long end; tax exemption at short – artificial scarcity). Plus lower subsidy changes the decision metric***
- ***Cap deductions at dollar amount***
  - ***Most draconian of the proposals – other deductions would likely crowd out municipal bond interest, making them effectively taxable***
- ***Cap deductions at 28%***
  - ***There would likely be a sell-off ; bonds would cheapen; but mutual funds maybe not hit as hard given they are more "mom and pop" (i.e. 28%) investments***

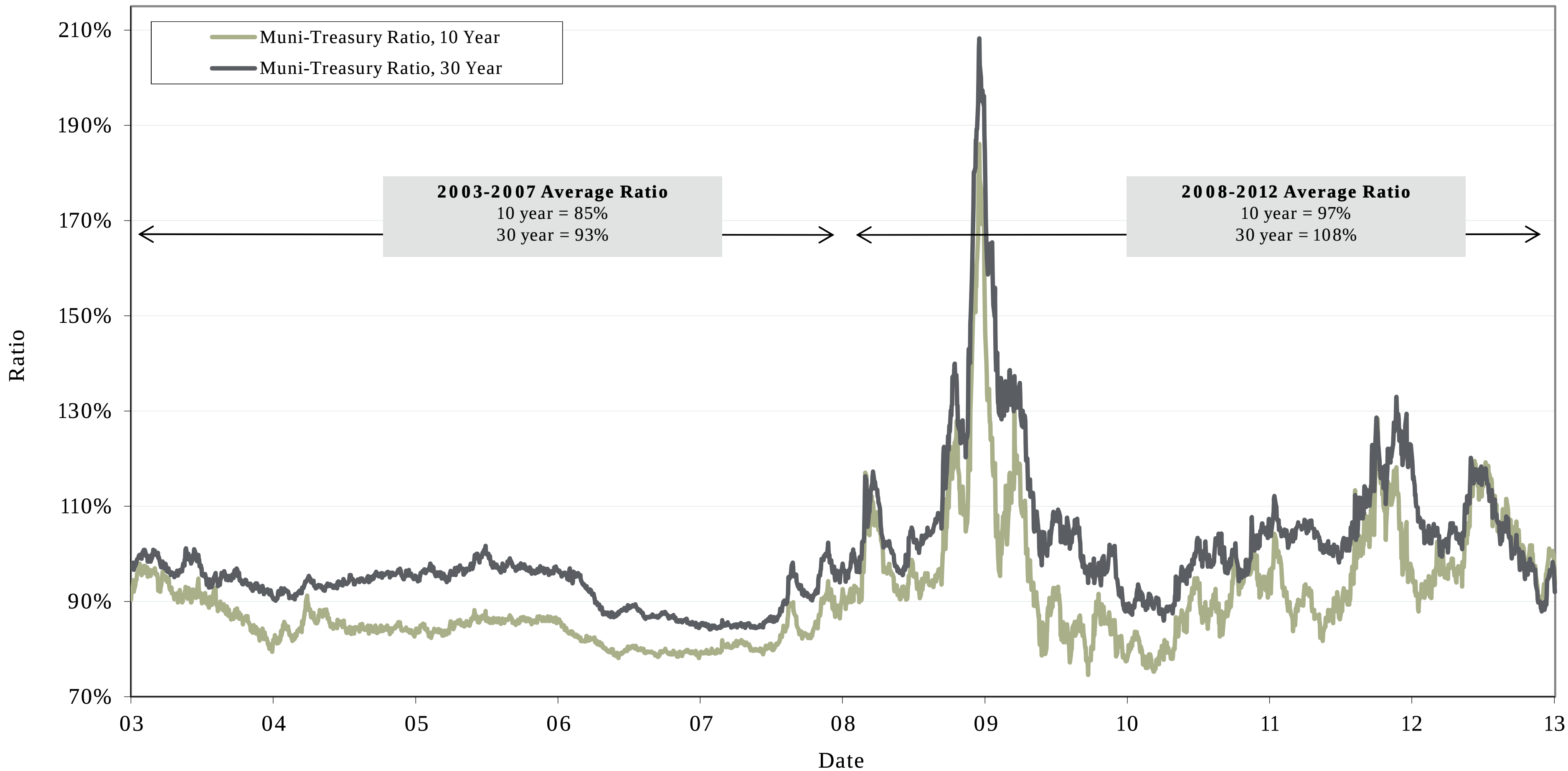
Federal Reserve Interventions 2008-2013 (as of January 14, 2013)

Interventions bolster market (but are they running out of steam?)
Twist-influenced yield curve; as did inflow of funds from around the globe;
Drop in long-term rates not good for long-term fixed income investors (i.e., pension funds, life insurance companies, endowments)
Incentives to reach for yield: i.e. riskier investment or further out the curve (but watch out for inflation!)



Market EKG: traditional relationships changed dramatically after 2008-2009

AAA GO Municipal-Treasury Ratios (2003 - Present*)



* As of January 3, 2013
Source: Thomson Reuters and Wells Fargo Securities, LLC analysis

A Proxy for Supply/Demand: IShares MUB—Jan. 1, 2007-Jan. 4, 2013 ($3.51 billion at Jan. 4, 2013)

- Note the sell-off beginning November 2010 through mid-January 2011
- Investors that bought on the sell-off saw double-digit returns in 2011
- Demand then jumped, February issuance volume increased and returns softened.

Shrinking government, by definition, reduces employment, whatever your views

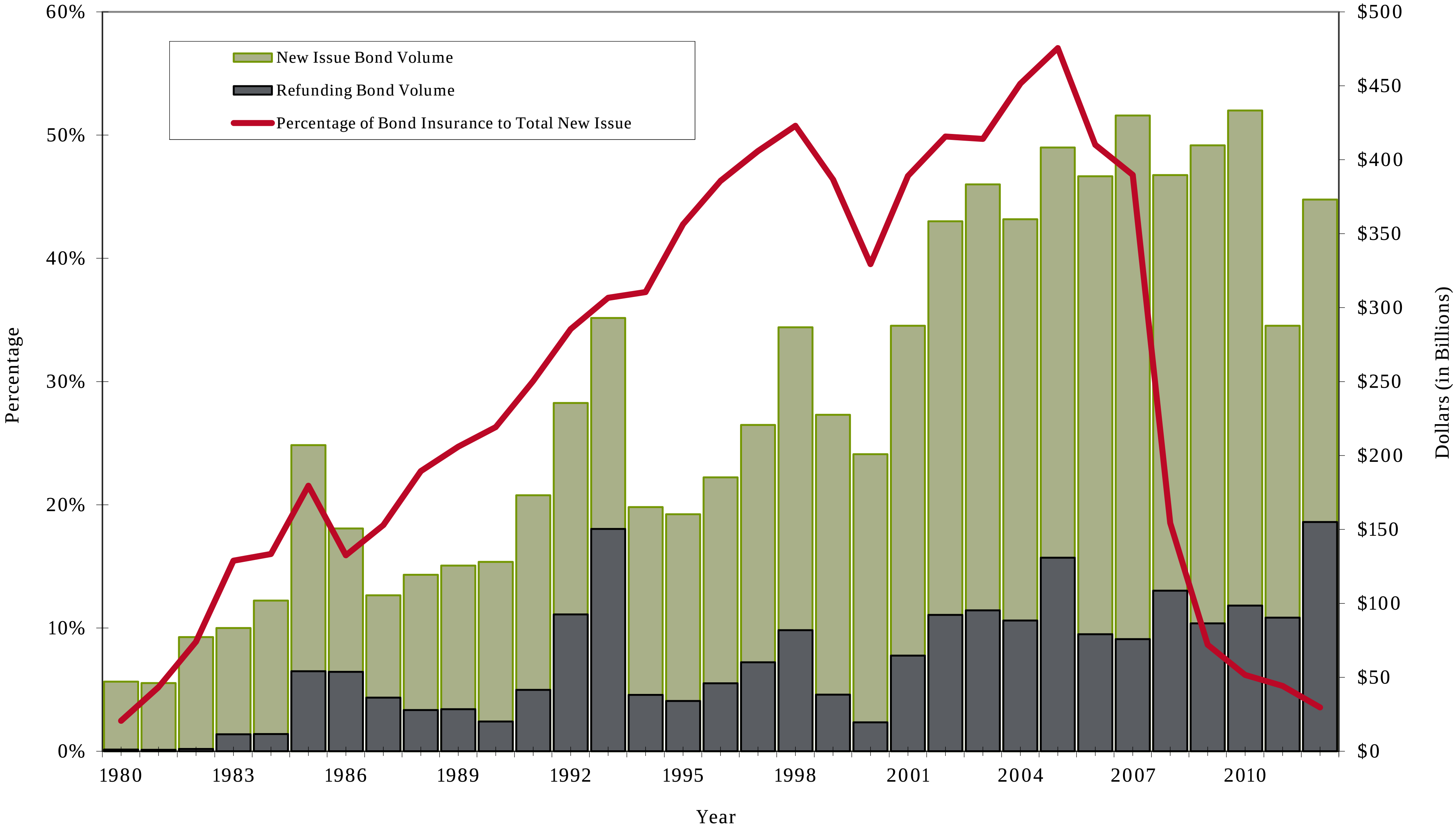
- Private Sector employment is growing enough to make up for government decline
- This growth has accelerated since 2009

US Non-farm and Government Employees, in thousands
November 2007 - November 2012 (preliminary), seasonally adjusted

	November Employment				
Period	**Total Nonfarm**	**Govt Total**	**Federal**	**State**	**Local**
2007	137,893	22,334	2,744	5,137	14,453
2008	135,040	22,558	2,780	5,190	14,588
2009	129,490	22,530	2,843	5,149	14,538
2010	130,226	22,278	2,865	5,135	14,278
2011	131,963	22,004	2,839	5,056	14,109
2012	133,852	21,962	2,799	5,079	14,084
Δ2007-2009	-6.09%	0.88%	3.61%	0.23%	0.59%
Δ2009-2010	0.57%	-1.12%	0.77%	-0.27%	-1.79%
Δ2009-2012	3.37%	-2.52%	-1.55%	-1.36%	-3.12%

Source: Bureau of Labor Statistics and Wells Fargo Securities, LLC

New Issue Volume (1980-2012*) and the Percentage of Bond Insurance



* As of December 31, 2012
Source: Bond Buyer, Assured Guaranty, Thomson Reuters and Wells Fargo Securities, LLC analysis

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- Or on Bloomberg at WFMU
- Also now available on Markit Hub (www.hub.com)
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Disclosure Appendix

Additional information is available on request.

This report was prepared by Wells Fargo Securities, LLC.

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Municipal Bonds Mayhem & Mystery

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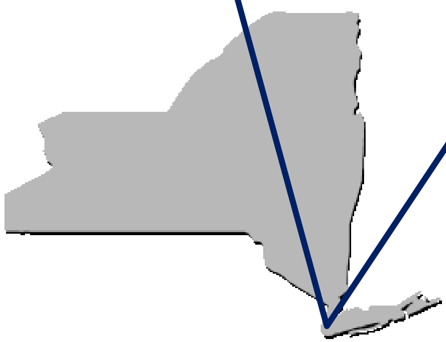

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Rosemawr Management

Municipal Special Situations and Credit Opportunities Investment Firm

Rosemawr

Management

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E info@rosemawr.com

Rosemawr Management LLC

- Founded in August 2008 by Greg Shlionsky, formerly Managing Director and Head of Municipal Derivative and Structured Products Trading at Lehman Brothers
- Focused exclusively on special situations and credit opportunities in the U.S. municipal bond market (including not-for-profits)
- Manages approximately $350 million[1]
- Utilizes no leverage and is interest rate neutral

Rosemawr Municipal Partners Fund L.P.

- Launched in May 2009 with a total return focus
- AUM approximately $185+ million (as of November 1, 2012).
- Since inception, the Fund has generated 12.6% net annualized returns
- Provides investors with quarterly liquidity

Rosemawr Capital I, L.P.

- An extension of the strategy utilized within the Rosemawr Municipal Partners Fund, L.P.
- Offers investors no liquidity during 5-year life (investment period of 2 years/harvesting period of 3 years)
- Expected holding period for investments of 12-36 months
- Focused primarily on new issue, publicly or privately offered investments
- Committed capital of $133.4 million
- Closed September 20, 2012

1. Includes committed capital and separate accounts 2.Past performance is not indicative of future results. Returns are presented net of fees and assume the reinvestment of earnings. Results shown are for Rosemawr Municipal Partners Fund, L.P., which employs a strategy and has terms that are different from Rosemawr Capital I, L.P. Please see important additional disclosures at the end of the presentation.

Portfolio Construction

Rosemawr Management

Investment sectors

- General obligations
- Infrastructure finance
- Essential services
- Student loans
- Healthcare
- Special tax districts
- Housing
- Utility and project finance
- CCRC/Skilled nursing
- Student housing
- Universities, foundations and cultural institutions

Instruments

- Publicly-issued bonds
- Private placements
- Loans
- Receivables financing
- Equity

Portfolio construction, credit and liquidity

- Subject to concentration limit by any single issuer depending on internally assigned credit rating:
  - 20% for internally rated A (or higher)
  - 15% for internally rated BBB
  - 10% for internally rated BB (or lower)
- No required diversification by sector
- Credit quality of investments may include distressed

Transaction size and holding period

- Typical deal size will be in the range of \$5–30 million
- Expected holding period will be 12–36 months
- No leverage to be employed as part of the investment strategy (though permitted to be used as needed)

Rosemawr employs a proactive and disciplined approach to identify and capitalize on market opportunities:

Sourcing

Private Deal Sourcing

- Dedicated effort to source transactions directly from issuers (via intermediaries)
  - Investment Banks
  - Regional Dealers
  - Financial Advisors
  - Bond/Underwriter's Counsel
  - Issuing Conduits
  - Feasibility Consultants

Secondary-Market Sourcing

- Extensive network of dealers covering the firm
- Insurers and institutional investors

Analysis and Execution

- Analysis and understanding of sector and industry dynamics
- Thorough due diligence of financials, legal structure, credit and local governance
- Engage third-party party experts where appropriate
- Assess likelihood of a catalyst
- Negotiate security package

Value Realization

- Engage with the issuer to achieve catalyst event
  - Refinancing/Recapitalizations
  - Credit/Interest Rate enhancements
  - Merger or other operational change
- Monetize value through a sale in the secondary markets
  - Credit improvement
  - Ratings/upgrade
  - Project stabilization

Target Transactions

Rosemawr Management

- Typical deal size of $5–$30 million (larger commitments can be made with co-investors)
- Stakes acquired may comprise sole ownership or part of the capital stack
- Expected holding period of 12–36 months
- Bonds purchased generally have maturities greater than 15 years (long, premium call or non-callable)
- Credit quality of investments will be below A rating and will include distressed
- Coupon/yield of bonds will typically be between 6.00% and 9.00%
- Most investments will have a dedicated revenue/tax pledge, mortgage or other assets as security

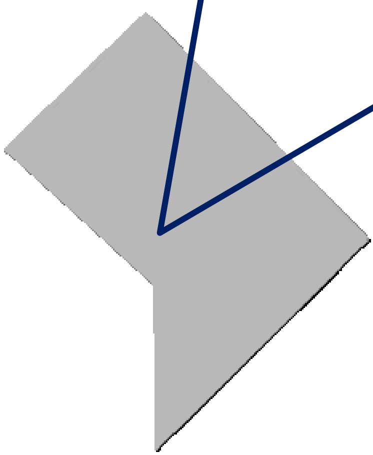
What Rosemawr Brings to the Table

- Attractive alternative to traditional institutional investors
- Experienced municipal professionals—credit/derivatives, capital markets, banking
- Solutions oriented: eager to be part of the structuring discussion
- Able to execute and deploy capital quickly (all credit and investment decisions made by principals)
- Invests in both taxable and tax-exempt securities
- Flexible investment format (public/private deals, cusip/non-cusip, rated/non-rated, no offering documents)
- Combination construction and permanent financing options (draw down)
- Invests across the capital stack, including equity
- Deploys capital across all industry sectors
- Minimal size limitations (minimums and maximums)

Municipal Bonds Mayhem & Mystery

Eric Silva

Legislative Representative
Winston & Strawn
Washington, DC



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Thursday, January 24, 2013 @ 1:00pm Eastern

CDFA – Stifel Nicolaus Innovative Deals Webcast Series
Thursday, February 14, 2013 @ 1:00pm Eastern

CDFA – BNY Mellon Development Finance Webcast Series
Tuesday, February 19, 2013 @ 1:00pm Eastern

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