# Municipal Market UPDATE

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INVESTMENT BANKING SINCE 1917

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- **Muni Volume Reverses Negative Trend**
- **Variable Rate Market Update**
- **2014 First Half in Review**

## Muni Volume Reverses Negative Trend

Despite overall decreased levels of muni volume for the first half of 2014, June was the first month long-term muni issuance exceeded its 2013 total. According to Thomson Reuters, volume increased 30.6% from $26.1 billion in June 2013 to $34 billion for the same time period in 2014. However, total volume continues to be well below 2013 levels, down from $179 billion through June 2013 to $149 billion for the first half of 2014.

Similar to overall muni issuance, refunding volume through June is also down from its 2013 levels from $71.7 in 2013 to $49.15 this year. However, refunding volume also exceeded year over year totals this month with $12.40 billion, compared to $6.86 billion in June 2013.

The Municipal Market Data ("MMD") 'AAA' Muni Market 10 year yield ended June at 2.26%, 10 basis points ("bps") above where it stood at the end of May; the 30 year yield increased 2 bps, from 3.26% at the end of May to 3.28% at the end of June.

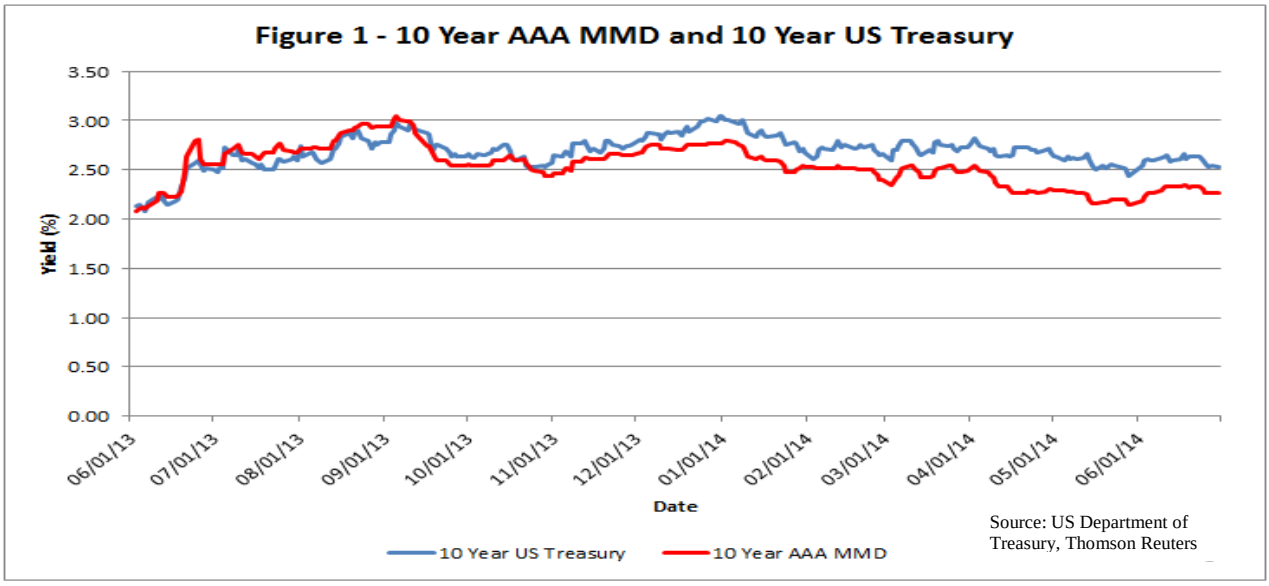
The 10-year US Treasury yield ended June at 2.53%, up 5 bps from 2.48% at the end of May.

The 30-year Treasury yield increased by a mere 1 bps from 3.33% at the end of May to 3.34% at the end of June.

As of June 30th, the ratios of 'AAA' General Obligation municipal yields to Treasury yields were:

| Year | Yield | % Yield |
|---|---|---|
| 1-Year | 0.11 / 0.11 | 100.00% |
| 5-Year | 1.20 / 1.62 | 74.07% |
| 10-Year | 2.26/ 2.53 | 89.33% |
| 30-Year | 3.28 / 3.34 | 97.90% |

Sources: The Bond Buyer, Bloomberg, US Department of Treasury, US Federal Reserve



**Variable Rate Market Update**

The SIFMA Municipal Swap Index, an average of high-grade, tax-exempt, variable rate bonds increased from .05% at the beginning of June to end the month at .06%. The 30-day LIBOR also increased slightly in June, beginning the month at .1510% and ending at .1552%. Please refer to Figure 2 below for historical SIFMA and LIBOR rates.

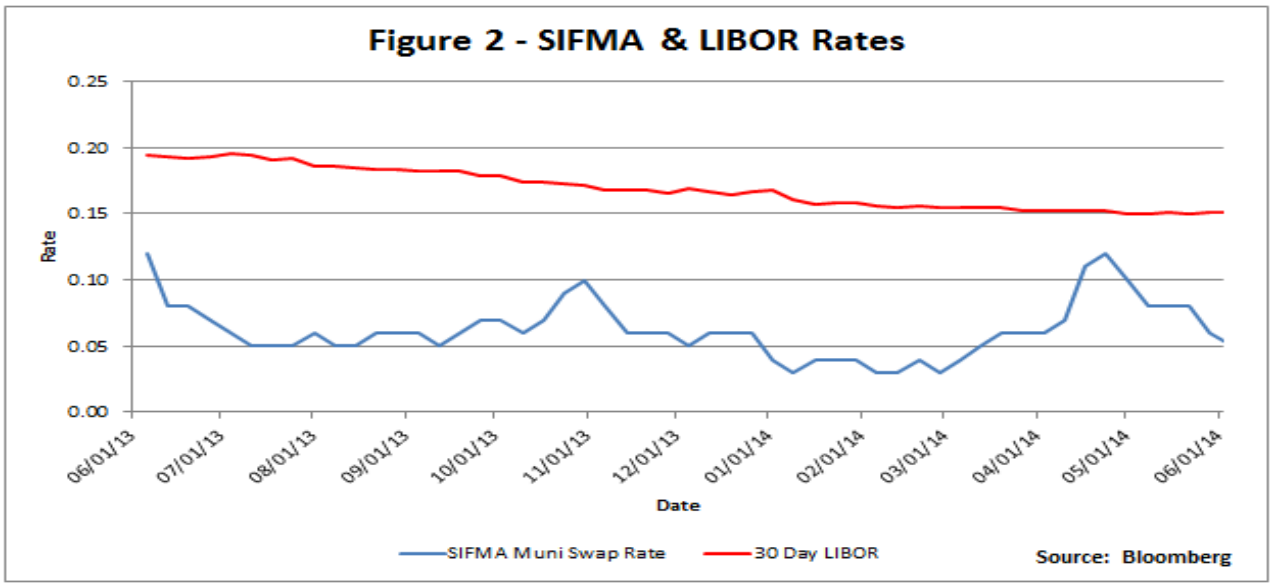
Sources: The Bond Buyer, Bloomberg, SIFMA

**2014 First Half in Review**

The big theme of the municipal bond market through the first six months of 2014 is a decline in volume which triggered a rather large drop in rates, which in June at least, may have finally begun to bring some issuers off of the sidelines. Whether the last month's increase in volume is something that can be sustained remains to be seen, and of course, credit concerns about a major issuer have predictably cropped up reminding everyone that in the new muni market, business as usual (aka, life before the recession) still remains elusive and may possibly never come back.

**#1 Large Drop in Issuance**

It's difficult to overstate how drastic the decline in municipal bond issuance has been in the first six months of 2014 and the effect it has had on the market. Total long term bond issuance was down $29 billion from 2013, or 16%, even despite a strong June, which was the only month in 2014 that saw more bonds issued than the same time frame a year ago, with a year over year increase of $8 billion. By historical standards, 2013 was a low issuance year so 2014's drop from that level, despite very low interest rates, has been evidence of a larger issue enveloping the municipal capital markets. It seems that after years of borrowing to fund investment in their communities and institutions the recession has forced a renewed focus on strengthening balance sheets and providing basic services. This is an



encouraging trend for the long term success of over indebted municipalities; however, with an aging infrastructure in many critical areas it's one that can't last forever. Initial indications are that issuance should pick up in 2015 as projects that have been delayed for the last several years can no longer be put off and will have to finally be financed.

**#2 Causing a Drop in Rates and Spreads**

Another trend which has been prevalent through the first half of 2014, as it has been for most of the last several years, is historically low interest rates. After a moderate run-up in late 2013, overwhelming demand for scarce municipal bonds has forced rates back down. 20 year AAA G.O. bonds have declined from 3.89 at the beginning of the year to 3.04 at the end of June, an 85 basis point decline. Evidence that this is a supply crunch can be found in that what are called spreads, the difference between AAA and lower rated bonds, also tightened during the year. At the open of January Baa rated G.O. bonds traded at 5.32, or 143 basis points above the AAA bonds. On June 30th that spread had narrowed to 113 basis points, which is generally considered an indication that lack of supply has forced investors to be less discerning about the credit quality of the bonds they buy and bid up the prices (driving down the yields) of lesser rated bonds.

**#3 Puerto Rico Concerns Return**

In what seems to have become an annual summer tradition where one overleveraged issuer steps forward to enliven the headlines with serious fiscal problems, Puerto Rico has followed in the footsteps of Jefferson County, Alabama and Detroit. Stuck in a legal limbo with no recognized way of reducing debt for itself or any of its agencies, the Commonwealth enacted legislation in June that could pave the way for its deeply indebted electric utility to seek principal reductions from bond investors. Legal challenges soon followed and the Commonwealth's politicians were quick to point out that the legislation only applies to the utilities and not tax based debt, but the investment community wasn't buying it. Moody's quickly cut the ratings for all levels of the Commonwealth's debt, although the utility made its scheduled July 1st debt service payment. Unlike most municipal bond issuers, the Commonwealth has no clear cut path to restructuring. This is similar to U.S. States who have no legal provision available to file bankruptcy. Puerto Rico's legislature may be attempting to gain some leverage for voluntary negotiations with creditors. If so, it's a dangerous game to play. The market has been rattled enough by the new law that it has undone assurances from the Commonwealth's governor earlier this year that allowed it to borrow to fund operations. Future access to the market on less than onerous terms now appears to be doubtful. Puerto Rico has used its bond market mulligan and now needs to operate on a balanced budget, including massive debt service payments, if it is to avoid a default.

Sources: Thomson-Reuters, Moody's, The Bond Buyer, and Bloomberg

**June 2014 Selected Bond Issues**

**General Obligation and Essential Service Revenue**

| Sale Week | Par Amount ($ mil) | Issuer | Project | Ratings | Final Maturity | Yield | Spread to MMD | Notes |
|---|---|---|---|---|---|---|---|---|
| 6/3/2014 | $44.64 | Durham County, NC | General Obligation Refunding Notes | Aaa/AAA/ | 4/1/2034 | 3.250% | 18 | |
| 6/11/2014 | $5.38 | City of Parkville, MO | Brush Creek Drain NID General Obligation | /AA-/ | 3/1/1934 | 3.600% | 20 | |
| 6/4/2014 | $5.79 | City of Lorain, OH | Public Improvement Bonds | A3/AA/ | 12/1/2034 | 4.000% | 85 | BAM Insured |
| 6/24/2014 | $8.32 | City of Lancaster, OH | Public Improvement Bonds | Aa3/ / | 12/1/2043 | 4.100% | 74 | |
| 6/9/2014 | $13.14 | City of Yakima, WA | Public Improvement Bonds | /AA-/ | 6/1/2024 | 2.500% | 21 | |
| 6/25/2014 | $10.00 | Township of Manheim, PA | General Obligation Refunding Bonds | /AAA/ | 12/1/2034 | 3.150% | 8 | Bank Qualified |

**Education Sector**

| Sale Week | Par Amount ($ mil) | Issuer | Project | Ratings | Final Maturity | Yield | Spread to MMD | Notes |
|---|---|---|---|---|---|---|---|---|
| 6/3/2014 | $33.38 | Saratoga County, NY Capital Resource Corp - Skidmore College | College & Univ. Revenue Refunding Bonds | A1/ / | 7/1/2033 | 4.050% | 103 | |
| 6/2/2014 | $5.34 | Southwestern Iowa Community College | College & Univ. Revenue Bonds | A3/ / | 6/1/2034 | 3.950% | 93 | Bank Qualified |
| 6/26/2014 | $6.09 | Atlanta, GA Development Authority | Georgia Tech ATDC Project - Revenue Bonds TXBL | A2/A/ | 1/1/2035 | 5.350% | 225 | |
| 6/26/2014 | $17.55 | California State Municipal Finance Authority | Touro College Project - Revenue Refunding Bonds | / /BBB- | 1/1/2040 | 4.350% | 109 | |
| 6/30/2014 | $9.66 | Washburn University, KS | Revenue Refunding Bonds | A1/ / | 7/1/2029 | 3.540% | 81 | Bank Qualified |

Source: Bloomberg

**June 2014 Selected Bond Issues**

**Water & Sewer / Utility**

| Sale Week | Par Amount ($ mil) | Issuer | Project | Ratings | Final Maturity | Yield | Spread to MMD | Notes |
|---|---|---|---|---|---|---|---|---|
| 6/17/2014 | $29.83 | Watereuse California Finance AUthority | Vallejo Sanitation & Flood Refunding Bonds | /AA-/ | 5/1/2036 | 3.710% | 46 | |
| 6/4/2014 | $15.99 | Clark County, WA | Water Utility Improvement Revenue Bonds | Aa2/AA/ | 1/1/2034 | 3.370% | 27 | |
| 6/1/2014 | $38.18 | City of Garland, TX | Water Utility Improvement Revenue Refunding Bonds | /AA-/AA+ | 3/1/2034 | 3.400% | 40 | |
| 6/10/2014 | $8.97 | City of Ferndale, WA | Water & Sewer Revenue Bonds | A3/AA/ | 11/1/2033 | 3.850% | 74 | Bank Qualified BAM Insured |
| 6/16/2014 | $20.47 | Passaic Valley, NJ Water Commission | Water Utility Improvement Revenue Bonds | A1/AA/ | 12/15/2033 | 3.740% | 59 | AGM Insured |

**Healthcare Sector**

| Sale Week | Par Amount ($ mil) | Issuer | Project | Ratings | Final Maturity | Yield | Spread to MMD | Notes |
|---|---|---|---|---|---|---|---|---|
| 6/26/2014 | $46.48 | Burleigh County, ND Health Care | St. Alexius Medical Center Project | /BBB+/BBB+ | 7/1/2035 | 4.350% | 125 | |
| 6/26/2014 | $58.75 | South Dakota State Heath & Educational Facilities Authorities | Avera Health System - Revenue Bonds | A1/AA-/ | 7/1/2044 | 4.020% | 73 | |
| 6/5/2014 | $32.69 | Oak Valley, CA Hospital District | GO Refunding Bonds | A2/ / | 7/1/2035 | 4.160% | 101 | |
| 6/1/2014 | $14.69 | Rankin County Hospital District, TX | Health, Hospital, Nursing Home Improvement Bonds | A2/ / | 8/15/2029 | 3.900% | 124 | |
| 6/24/2014 | $64.43 | San Gorgonio, CA Memorial Healthcare District | Healthcare Refunding Bonds | A3/ / | 8/1/2039 | 4.750% | 144 | |

Source: Bloomberg