

Puerto Rico Extends Legal, Advisory Contacts After Debt Default.

Puerto Rico extended contracts worth \$3.2 million with outside restructuring firms as the commonwealth defaulted on nearly \$1 billion of principal and interest on July 1 and federal lawmakers passed legislation to oversee the island's finances.

The commonwealth continued agreements with Cleary Gottlieb Steen & Hamilton LLP and Millstein & Co. on July 1, according to a review of contracts provided by the island's Office of the Comptroller. That same day, Puerto Rico missed payments to general-obligation bondholders, the biggest default ever in the \$3.7 trillion municipal-bond market.

Cleary Gottlieb, a New York-based law firm, will earn \$2 million through June 30, 2017, for its advice as Puerto Rico seeks ways to reduce its \$70 billion debt load. The commonwealth's Fiscal Agency and Financial Advisory Authority is set to pay Millco Advisors LP, an affiliate of Washington-based Millstein & Co., \$1.2 million for financial expertise, including \$450,000 for possible expenses in any potential lawsuit or investigation regarding the firm's restructuring work with the commonwealth. The one-month contract ends July 31. Millstein has a separate \$3 million agreement with Puerto Rico that runs through December and would compensate the firm if a restructuring deal is finalized.

Shannon Lynch, a spokeswoman for Cleary Gottlieb, and Jenni Main, Millstein's chief financial officer, declined to comment.

The two firms have been advising Puerto Rico since February 2014 on how the commonwealth can reduce its obligations and negotiating on its behalf with creditors. President Barack Obama enacted on June 30 a law that creates a federal control board to oversee a restructuring of Puerto Rico debt and to monitor the island's budgets. The next day, the commonwealth defaulted on nearly \$1 billion due to bondholders, including \$780 million on general-obligation bonds.

Cleary Gottlieb contracts totaled \$24.9 million and Millstein agreements were \$16.4 million through June 30, 2016, according to the Office of the Comptroller.

Bloomberg Business

by Michelle Kaske

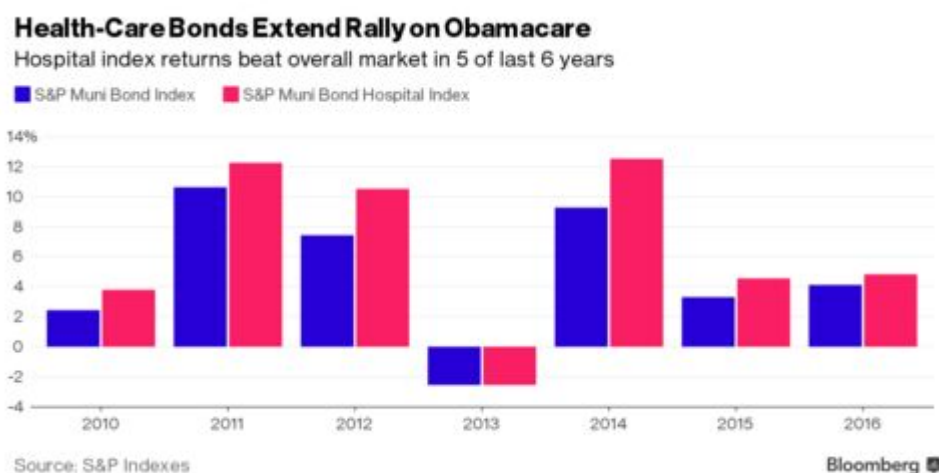
July 28, 2016 — 2:02 PM PDT

Hospital Bond Rally Undeterred by Latest Threat to End Obamacare.

The \$250 billion municipal hospital-bond market is proving immune to Donald Trump's plan to eliminate Obamacare.

Sutter Health is among nonprofits tapping demand for the tax-free debt, with the California chain planning to sell \$850 million in new securities this week. Health-care bonds are beating the overall \$3.7 trillion municipal market for a third straight year as the federal law expanding medical coverage to Americans improves business. Despite the Republican presidential nominee's goal, the rally has been undaunted as investors hunt for yield while rates hold near record lows.

"There's lots of demand with all of the money pouring in," said Mike Quinn, a managing director at Chicago-based investment bank Ziegler, which underwrites bonds for hospitals. "This is a really great environment for health-care borrowers to issue tax-exempt money."



Borrowing costs have tumbled this year with money flooding into the securities amid turmoil in financial markets overseas, pushing the Bond Buyer's 20-year index to as little as 2.8 percent this month, the lowest since the data began in 1961. Debt issued for hospitals has returned 4.8 percent this year, outpacing the 4.1 percent gain for the market overall, according to Standard & Poor's indexes.

Much of the financial gains from President Barack Obama's overhaul have already emerged, with about 20 million people gaining coverage through private insurance plans or state Medicaid programs since the passage of the law in 2010. Hospitals are now facing the prospect of reduced reimbursements as the government aims to shift from a model where it pays for services to one where it rewards outcomes.

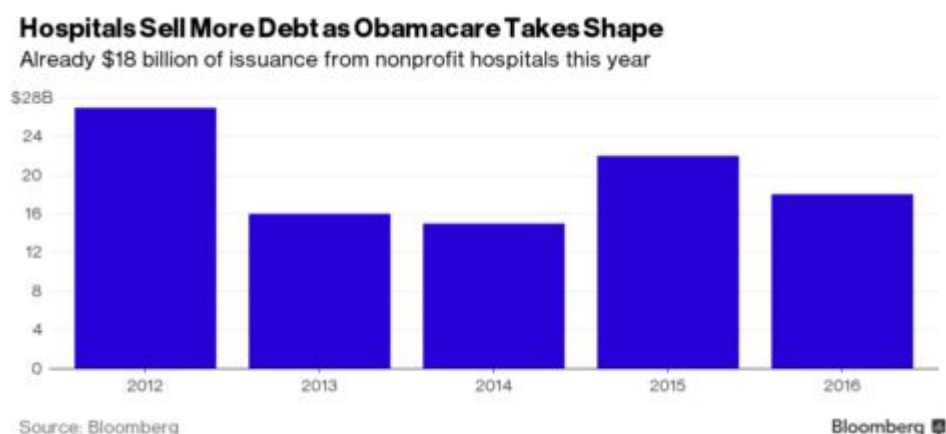
Republicans have repeatedly failed to repeal the law in Congress, and court challenges to its key provisions were turned away by the U.S. Supreme Court. While Trump has pledged to ask Congress to scrap it as soon as he takes office, doing so outright would be difficult politically given how many Americans are now covered by it, Morgan Stanley analysts said in a July 12 report.

For S&P Global Ratings and Moody's Investors Service, U.S. hospitals will manage the risks without undermining their credit ratings. Both companies have stable outlooks on the sector, meaning downgrades and updates will be roughly equal.

"We're about to enter a period with more uncertainty, but the organizations have very strong balance sheets and operations," said Kevin Holloran, an analyst at S&P. "The health-care system in America has proven over time to be very resilient and successful."

After sitting on capital plans as implementation of Obamacare started, hospitals ramped up

borrowing last year to retire more costly debt, with sales this year already exceeding those in 2014 and 2013.



Sutter, which is issuing securities Tuesday through the California Health Facilities Financing Authority, is using the proceeds to refinance higher-cost debt and to help fund two new hospitals in San Francisco. Based in Sacramento, it runs 28 acute-care facilities, two recovery hospitals, four medical foundations and 15 home health-care locations.

“We have a consistent operating performance and excellent long-term stewardship of our balance sheet,” said Svend Ryge, Sutter’s treasurer.

Moody’s ranks the debt Aa3, the fourth-highest grade, citing its stable cash flow and its strong presence in California.

The breadth of the company’s business in California is a draw, said Todd Sisson, a debt analyst in Charlotte, North Carolina, for Wells Capital Management, which owns Sutter bonds among its \$40.5 billion in municipals. While the company may buy some of the new securities, it’s limiting holdings of health-care debt because of the price run up and cuts providers face after reimbursement changes begin next year, he said.

“We’ve got considerable headwinds,” Sisson said. “The sector’s outperforming at the same time we’re seeing the risk increase.”

Sutter will see Medicare payments actually increase annually through 2019, bond documents show. Still, “estimates of future impact would not be reliable” from later calculations of reimbursements, according to the statement.

The industry has “immunity” to uncertainty, said S&P’s Holloran. “People still get sick, go to the doctor, get surgeries.”

Bloomberg Business

by Molly Smith and Romy Varghese

July 25, 2016 — 2:00 AM PDT Updated on July 25, 2016 — 6:46 AM PDT

What America Might Look Like If These 6 Issues Are Neglected.

America's challenges will get worse without the support and commitment of the next administration to city issues

For over a year, the nation – and the world – has been wrapped up in the contest for the highest office in the land. We've seen 17 Republican presidential hopefuls whittled down to a businessman billionaire. We've seen a political revolution stopped short by a former Secretary of State and First Lady. We've seen mean tweets and rowdy stump speeches, #NeverTrump and a Speaker's endorsement, and a lot about those damn emails.

It's been a wild ride for sure. But let's be frank: it's time to get serious. At the National League of Cities (NLC), our goal is to empower local leaders to do what they do best: create environments that support families and businesses, and strengthen local economies. Cities and towns need a strong partner in the next administration. The candidates must engage in dialogue reflective of how government actually works. We need less talking points, and more policy, or the problems being ignored in 2016 will look easy by the year 2020. Here's what's at stake if we don't:

1. Infrastructure Will Continue to Decline, Hurting American Competitiveness

The future of American infrastructure looks grim. The American Society of Civil Engineers (ASCE) [gave the U.S. a D+](#) for overall infrastructure in 2013. From energy to hazardous waste, the U.S. is just points away from a failing grade in numerous categories. One in nine bridges is structurally deficient; 45 percent of American households have no access to public transportation; an estimated [240,000 water main breaks](#) happen each year – just to name a few challenges.

Today, 80 percent of Americans live in cities, a number which is projected to increase in the next decade. Surging population growth will put stress on already strained infrastructure, causing more damage and hastening decay, even by 2020. While municipal governments are responsible to their constituents, they are not empowered to raise the revenue necessary to invest in long-term solutions. Cities need a strong partner in the next administration to keep infrastructure from falling into further disrepair.

2. Affordable Housing Will Be Increasingly Hard to Find

The market for affordable housing in the U.S. is rapidly shrinking. According to the Joint Center for Housing Studies, the [number of new renters](#) will outpace the number of new homeowners significantly over the next 15 years, raising rental property values and reducing the amount of overall affordable housing. This comes at a time when funding cuts have limited federal and local government investments in the construction of new affordable housing.

Meanwhile, as metro-areas continue to grow, moderate to low-income homes will be forced to find new housing accommodations or contribute more of their salary to rent. In 2013, [over half of families](#) with low to moderate-incomes spent over 30 percent of their income on rent, leaving less money for essentials like groceries and healthcare, not to mention savings accounts, retirement funds or other wealth-building systems. The next administration must work with cities to ensure safe, affordable and accessible housing remains a core element of the American Dream.

3. Natural Disasters Will Become More Challenging to Manage

Climate change affects cities differently across the U.S., but as average temperatures and sea levels

rise, environmental and natural challenges will become more frequent and more devastating. Recently, Hurricane Sandy [left between \\$10 and \\$15 billion in damages](#) to infrastructure and private property. Cities located in the Gulf and along the Atlantic face threats to basic amenities like clean water and energy, a sector [the U.S. Department of Energy](#) reported will be particularly vulnerable to future storm damage.

In a different part of the country, the National Climate Change Assessment found that changes in rainfall and high temperatures will affect the lives and economies of [56 million people](#) in the South and Southwest. Drought has decimated water supplies and changing weather patterns will make it difficult to predict precipitation, increasing competition for resources amongst cities. To prevent further loss, cities need significant investment in climate-resilient architecture and construction.

4. Local Economies Will Lack Skilled Workers to Drive Economic Growth

There are two different storylines playing out in cities: economic conditions are improving for some, but stagnating or worsening for others. While addressing rising inequality may require multiple policy solutions, what we do know is the changing nature of the economy, from advances in technology to shifts in the global market, underscore the need for proactive and effective workforce development.

[According to city leaders](#), new businesses and business expansions are the most widespread positive drivers of local economic health. However, labor force challenges threaten to stymie this business growth and the economic benefits that would follow. City leaders report that the misalignment between available workforce skills and the skills employers' need is the most widespread concern facing local economies. This concern will only grow if we fail to tackle the challenge.

5. The Opioid Epidemic Will Devastate More Families

Drug overdose is the leading cause of accidental death in the U.S., with 47,055 lethal drug overdoses in 2014. Opioid addiction is driving this epidemic, with 18,893 overdose deaths related to prescription pain relievers, and 10,574 overdose deaths related to heroin in 2014 ([CDC 2015 Report](#)). From 1999 to 2008, overdose death rates, sales, and substance use disorder treatment admissions related to prescription pain relievers increased in parallel. The overdose death rate in 2008 was nearly four times the 1999 rate; sales of prescription pain relievers in 2010 were four times those in 1999; and the substance use disorder treatment admission rate in 2009 was six times the 1999 rate.

By 2020, if we don't stem the tide, these troubling trends will continue. In the U.S., we have reduced the number of smokers, the number of teen pregnancies, and the number of new HIV/AIDS infections over time. The lessons from these public health challenges can be applied to the present opioid drug epidemic. To make real progress in the fight against opioid addiction, all levels of government must work together in partnership.

6. More Lives Will Be Lost to Gun Violence

The U.S. has the highest homicide-by-firearm rate of any developed country. In 2015 alone there were 52,606 gun-related incidents resulting in 13,344 deaths. While Congress fails to address this epidemic, communities suffer the violent consequences. In 2020, we can expect wide-spread gun violence to be a persistent tragedy of life in America if don't take action.

To reduce gun violence, legislation that regulates the possession of firearms is essential. NLC supports universal background checks on purchasers of guns, banning the sale of firearms to those

on the terror watch list, and a 30-day waiting period for the purchase and transfer of all firearms. Within the past four years, we have witnessed tragedies in Newtown, CT, Aurora, CO, and Orlando, FL. There is no evidence that continued inaction from the federal government will end the violence. If the status quo is maintained, we will see continued loss of life in our communities.

The challenges cities face in the next four years are immense, but not insurmountable—and they can't be solved by one level of government. In the next president, we need not only a leader, but a listener and collaborator. Whether Trump or Clinton, the future of our nation depends on what happens in cities.

[Show your support and sign onto our Cities Lead campaign.](#)

National League of Cities

by Carolyn Coleman

About the Author: Carolyn Coleman is NLC Senior Executive and Director of Federal Advocacy. Follow her on twitter at @CColeman_Cities.

Where Are the P3s We Need?

We ought to be doing what many other countries are doing: making far more use of public-private partnerships for infrastructure.

Public-private partnerships may seem like the latest innovative way to finance crucial public needs, but P3s have been around for a while — quite a long while. In a recent [Governing Guide to Financial Literacy](#), Justin Marlowe describes a Revolutionary War public-private partnership as a key factor in George Washington's defeat of the British. After a grim winter spent at Valley Forge, where soldiers starved and died of disease, the Continental Congress authorized a reorganization of the army's supply system and gave private contractors wide latitude in managing the logistics.

As successful as this arrangement was early in our history, we make far less use of such partnerships today than many other developed countries do. A study by the U.S. House Transportation and Infrastructure Committee found that while more than \$61 billion was spent on highway P3s in this country from 1989 to 2013, that amount represented just 1.5 percent of the costs of all highway projects completed during that period.

Why such a small percentage? Well, it isn't for lack of need. A 2015 Governing Institute survey found that half of state and local public officials believe lack of infrastructure investment is their most significant financial problem. Traditionally, governments have tapped tax-exempt bond markets to provide low-cost capital. But access to this market can be restricted for a variety of reasons, including limited bonding capacity or poor credit ratings, so P3s have the potential to bring in private-sector money to jump-start projects that might not happen otherwise. In countries that make strong use of them, P3s typically constitute about 5 to 10 percent of overall investment in infrastructure.

To be sure, there are hurdles to creating public-private partnerships. For starters, they require authorizing legislation. While most of the early P3s centered on transportation (California was first to pass legislation in 1989, followed by Florida and Missouri the next year) projects today can cover virtually every type of public infrastructure. P3 legislation varies state to state, and the National

Conference of State Legislatures provides a [detailed table](#) of the specific types of authorized projects (including highways, toll bridges, buildings, and water and sewer systems) for each jurisdiction. As of this January, 33 states, Puerto Rico and the District of Columbia had enacted some form of legislation enabling P3s.

Given the gap between existing infrastructure needs and available funds, it's not surprising that a number of recent papers and reports offer analyses and recommendations to help catalyze the use of P3s. This May, the Bipartisan Policy Center issued "[Bridging the Gap Together: a New Model to Modernize U.S. Infrastructure.](#)" which outlines the core principles of a new American model for investing in infrastructure centered on P3s. Those principles include public benefits identified and clearly stated; investment decisions based on a full life-cycle evaluation; project benefits, cost and risks completely accounted for and made publicly transparent; sharing by public- and private-sector partners of risks, costs and benefits; and comparing the costs of action against the costs of not investing.

In a [recent paper](#), the West Coast Infrastructure Exchange points out that financing is just one of an entire set of project costs. The report segments these costs across the entire lifecycle of a project and describes how, through incentives, a focus on performance can integrate design, construction and maintenance responsibilities and counterbalance the higher cost of private capital to reduce overall project budgets.

That paper highlights British Columbia, with a relatively long history of using this performance-based P3 model, as a best-practice example: Since 2002, the province has completed 45 projects totaling \$17 billion (with over \$7 billion from the private sector). All of the projects were delivered on or before their due dates, and none had cost increases stemming from design or construction mistakes.

To be sure, developing a public-private partnership that's likely to succeed requires considerable public-sector expertise. But there is a growing body of resources available to government officials. Organizations such as the National Governors Association and the American Association of State Highway and Transportation Officials, for example, offer interactive courses and peer-to-peer workshops on infrastructure financing. The U.S. Department of Transportation offers technical assistance and resources for states. And three states — Florida, Texas and Virginia — have established dedicated agencies to help promote and evaluate P3 opportunities. Virginia has long been considered a leader in this approach, and its [website](#) is worthy of review.

Clearly there's a case for more use of P3s and other innovative approaches to meeting our growing infrastructure needs. The American Society of Civil Engineers' last [infrastructure report card](#), issued in 2013, gave a grade of D-plus to the overall condition of the nation's infrastructure, citing conditions that are well known not only to public officials but also to the public: a backlog of overdue maintenance and a pressing need for modernization. ASCE's next report card is due out this year. Will our grade be better? If not, that will certainly drive home the point that doing nothing has a cost.

GOVERNING.COM

BY BOB GRAVES | JULY 26, 2016

Many U.S. States, Cities, Missing Chance of Lifetime to Borrow.

NEW YORK/SAN FRANCISCO — The 1923 middle school building in Oregon's Corbett School District is so old that horses and trailers were used to dig the basement. It floods every winter, the building has no sprinkler system, and there is asbestos and lead paint in some spots.

Yet this May, voters struck down, for the fourth time, a plan to sell bonds that would pay for a new building, passing up an opportunity to finance the new school at a cost that may never be so low again.

Corbett is not alone. The amount of debt sold so far this year in the \$3.7 trillion market for U.S. municipal and state debt is less than in 2015 despite record-low borrowing rates.

The yield on top-rated municipal 30-year bonds hit a bottom of 1.93 percent on July 6. That is far below the 3.27 percent of a year earlier and even below the comparable Treasury yield thanks to an income tax exemption granted to U.S. investors on the interest earned on most muni bonds.

There are several reasons why municipalities are slow in exploiting what could be a rare window of opportunity created by historically low global rates and investors' intense hunt for higher returns.

For one, municipal borrowers have to clear hurdles including those at the ballot box, which makes it hard for them to respond quickly to changing market conditions.

Some communities are also still aching from recession-era budget cuts and remain reluctant to take on new debt service costs, however low they may be. Some are hemmed in by sluggish economies, big pension liabilities – which crowd out new projects – or both.

“Apart from the very large states and cities that typically are the leaders ... (others) are still not sure that they have the backing of the voting population or the economic resources to expand their spending,” said VanEck Global portfolio manager James Colby, who buys municipal debt for the firm's muni exchange traded funds.

For example, voters in Travis County, Texas, narrowly rejected a \$287 million bond that would finance a replacement for an old, overcrowded courthouse in Austin, in part because of concerns that the chosen location might be too expensive.

New Jersey halted many state-funded road and bridge projects this month after lawmakers failed to extend the program that funds them because of a continuing battle over how to hike gasoline taxes to pay for new transportation spending.

Dysfunctional politics and fiscal strain also derailed last year's budget in Illinois, which was a full year late, and in Pennsylvania, where a nine-month budget impasse left public schools struggling to stay open.

LESS DEBT

As a result, municipalities and states issued \$227 billion in debt between January 1 and July 19, down 1.6 percent compared with the same period of 2015, according to Thomson Reuters data. The lion's share of tax-exempt debt has been issued to refinance older bonds at lower rates, rather than fund new projects. (Graphic: <http://tmsnrt.rs/29MmnHb>)

Yet besides big issuers, in economically robust states, such as California and New York, it is America's most troubled borrowers that have increased new borrowing.

Some are selling bonds now because buyers who previously shunned them are piling in looking for extra yield. Other communities must borrow to cover running costs or finish essential projects.

With negative yields in Germany and Japan and a global hunt for fixed income assets because of market volatility, some foreign investors are also buying U.S. municipal bonds, even though they do not get any tax benefits.

“We’re the best name in town right now in a very low-yield environment,” Blair Ridley, municipal bond portfolio manager at Deutsche Asset Management, said during a recent webinar.

Municipal bond funds recorded consecutive net inflows for the last 42 weeks, according to Lipper data, with inflows this year so far reaching \$36 billion, compared with \$13.8 billion for the whole of 2015.

Yet prospective issuers still face voter resistance.

“It’s a result of the credit crisis, an aversion to debt, and trying to right size the balance sheet,” said Peter Hayes, head of municipal bonds at BlackRock.

In Corbett, since the \$11.9 million bond proposal was voted down, officials in the 1,100 student school district 20 miles east of Portland are now considering a costlier private loan that does not need voter approval.

“I keep telling people the interest rates are so low,” Superintendent Randy Trani said. “But it’s not happening.”

Some voters did not want to demolish a historical building. Many are also over the age of 50 and are averse to more costs, Trani said.

“They have no connection to the school at all. It’s hard to get them to vote to pay more taxes.”

By REUTERS

JULY 26, 2016, 6:18 A.M. E.D.T.

(Reporting by Hilary Russ in New York, Robin Respaut in San Francisco and Karen Pierog in Chicago; Additional reporting by Rory Carroll in San Francisco; Editing by Daniel Bases and Tomasz Janowski)

How to Save Public Pensions, No Federal Bailout Needed.

It isn’t unprecedented for the feds to spur local pension reform. Kennedy and Reagan both did.

The pensions of states and local governments are, collectively, trillions of dollars in the hole. This debt is crippling budgets and will dump an enormous burden on future generations. Yet state and local politicians have proven that they cannot, or will not, solve the problem. The federal government ought to step in. But how?

Instead of bailing out these pensions, Congress should pass a law allowing states and local governments to reduce promised benefits—something that is now illegal under some states’ statutes or constitutions. Congress should stipulate that pension plans must be in very bad shape to qualify

for relief, and the politicians in charge of them would have to voluntarily seek it. Most important, pensions should be required to uphold their original intent: to keep retirees who can no longer support themselves out of poverty.

Even with those restrictions, significant savings could be made. Many pensions allow retirement at age 55; states and local governments could mandate that benefits cannot be drawn until age 65. Payments could be capped at 150% of the median income in the local jurisdiction. Automatic cost-of-living increases that now exceed expected inflation could instead be tied to increases in the median income.

Troubled plans should qualify for relief only if their funding ratio falls below 50% and has failed to improve over the past five years. These are the plans that are in fiscal quicksand and cannot be saved without significant changes.

Local governments must also be required to terminate their defined-benefit plans. These should be replaced with defined-contribution plans, like 401(k)s or 403(b)s, or active employees could be enrolled in Social Security. Responsible officials are already taking this step: The board of the Tennessee Valley Authority voted in May to switch to a 401(k)-type plan and lower the cap on cost-of-living adjustments.

Once these steps are taken, the local government should be required to fully fund the remaining pension liability with a tax increase. That should be the deal: To receive the relief of reducing promised benefits, they must agree to solve the pension problem once and for all.

What would this look like in practice? Let's say that a retired firefighter in a troubled pension plan is set to receive \$70,000 annually. If that is below 150% of the median income in his local jurisdiction, under federal relief his annual benefits would never be subject to the cap, since they would rise as the local median income increases.

What about a retired cop who became a city councilman and later a county supervisor—an extreme, but not unheard of, case? The cop would not be able to collect three pensions and would have his benefit reduced to meet the cap. Both the firefighter and the politician would have to wait until turning 65 to receive benefits.

No one wants to see his benefits reduced. Yet keep in mind that a retiree who receives a \$75,000 pension for 30 years, with 3% compounded cost-of-living adjustments, gets total payments of more than \$3.4 million. This has become common in cities like Chicago.

I am not the first person to suggest federal intervention. Rep. Devin Nunes (R., Calif.) proposed withholding federal aid to government entities that don't accurately report pension funding. That would be a step forward but would not solve the problem of underfunding.

Diana Furchtgott-Roth of the Manhattan Institute has proposed a law that would allow local governments to seek relief from pension debt in bankruptcy court. But this leaves too much discretion to judges and could lead to wildly different outcomes. Plus, such open-ended relief would be fiercely fought by public-employee unions every step of the way.

Federal intervention is not unprecedented. The Windfall Elimination Provision of the Social Security Act, an amendment that was passed in 1983, allows the federal government to reduce Social Security payments when recipients also receive pensions from public employment. This has curbed double-dipping and protected the Treasury.

Nor should a new plan for federal relief be seen as a purely partisan issue. In 1961 President John F.

Kennedy established the Committee on Corporate Pension funds. This eventually led to the Employee Retirement Income Security Act of 1974, which outlawed abuses and forced private firms to put required money into their pension plans each year.

The plan outlined here would create a consistent and concrete path toward making pensions manageable for taxpayers. At the same time, it would protect retirement income for those unable to support themselves. The next president and Congress should take action to allow local governments to address this monumental problem—which gets worse by the day.

THE WALL STREET JOURNAL

By ED BACHRACH

July 17, 2016 7:22 p.m. ET

Mr. Bachrach is the founder and chairman of the Center for Pension Integrity.

[A President Trump Would Be Obstacle to Municipal Bonds' Bull Run.](#)

The municipal-bond market's rally is facing election year headwinds from Donald Trump.

The real estate developer and reality television star, who accepted the Republican presidential nomination Thursday night, has proposed slashing the top individual income-tax bracket from 39.6 percent to 25 percent, the lowest since 1931. That would sharply reduce the incentive to own tax-exempt bonds, whose yields have slipped to record lows as investors pour money into the safest assets and central banks hold down interest rates.

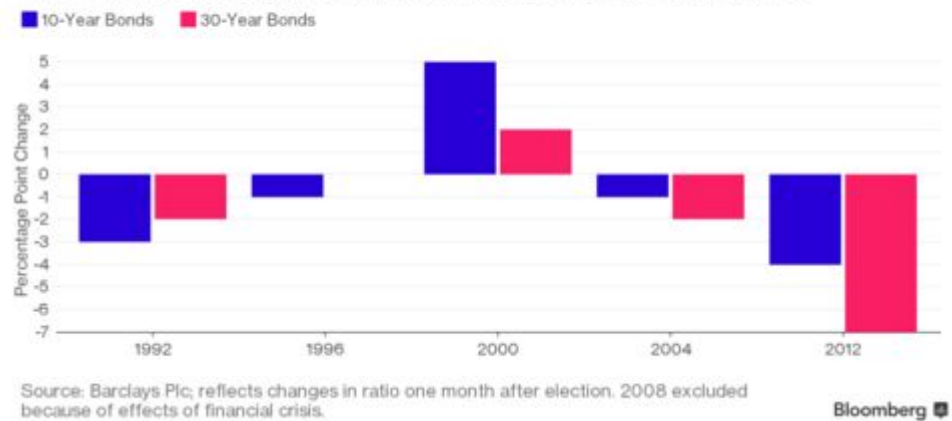
"He has a pretty aggressive tax reduction plan," said Mikhail Foux, head of municipal strategy at Barclays Plc in New York. "Taxes going down is always bad for munis compared to Treasuries."

U.S. presidential elections can have outsized significance for the \$3.7 trillion municipal market — a haven of buy-and-hold investors looking for tax-free income — because they often result in changes to tax policy. Typically, Republicans cut taxes on the highest earners, while Democrats raise them.

The benefit of owning state and local-government bonds over other fixed-income securities declines when levies are reduced and increases when they rise. Yields — which move in the opposite direction as price — fell relative to U.S. Treasuries after Bill Clinton's victories in 1992 and 1996, and again after President Barack Obama's re-election in 2012, according to Barclays. They increased after Republican George W. Bush's victory in 2000, which led to tax cuts.

Higher Taxes Tend to Be Good for Municipal Bonds

Ratio of Muni-to-Treasury Yields Falls When Tax-Break Becomes More Valuable



Top-rated 10-year municipal bonds yield 1.47 percent, or about 93 percent of what Treasuries with comparable maturities offer. For an investor in the top income-tax bracket, the tax equivalent yield is 2.6 percent, or about 1 percentage point more than Treasuries with the same maturity. At a top bracket rate of 25 percent, the tax-equivalent yield is 1.96, or about 0.5 percentage point more than Treasuries.

Municipal bonds have gained every year but one since President Barack Obama took office in 2009, according to Bank of America Merrill Lynch indexes, as the Federal Reserve held interest-rates near zero and taxes were raised on the highest earners.

Trump's plan is estimated to cut federal revenue by \$9.5 trillion and swell the debt by \$11.2 trillion over the next decade, according to the Tax Policy Center, a joint venture of the Urban Institute and Brookings Institution. The proposal may be scaled back: he's expected to release a revised plan that calls for reducing the top rate to between 28 percent and 33 percent, closer to what House Speaker Paul Ryan has endorsed, according to the Washington Post.

The demand for municipal bonds could also be eroded by Hillary Clinton's proposals, though not by nearly as much. While her plans include higher taxes on incomes over \$5 million, she has also endorsed establishing a minimum 30 percent levy on filers earning more than \$1 million and capping the value of tax exemptions, which could reduce the tax-breaks given to owners of the debt.

Municipal yields could increase by more than 1 percentage point under Trump's original plan and 0.35 percentage point under Clinton's, assuming prices are driven by investors in the highest tax bracket, according to Morgan Stanley's chief municipal strategist Michael Zezas.

But demand from lower-income investors could offset some of that: About 45 percent of returns that reported tax-exempt interest had adjusted gross incomes less than \$200,000, according to the Internal Revenue Service. And enacting major tax overhauls are difficult, regardless of who controls Congress.

"It's extremely difficult to get the consensus required for what might be called fundamental tax reform," said Phil Fischer, the head of municipal research at Bank of America Merrill Lynch. "Nobody knows what that is any more."

Barclays' strategists predict that if Trump wins, the GOP would likely control Congress but wouldn't have a super-majority in the Senate. After an initial period of volatility and a flight to safer assets, 10-year Treasury rates could rise as much as 0.5 percentage point because of fiscal stimulus

generated by individual and corporate tax cuts. With municipal rates forecast to increase even more, that may lead investors to pull money from mutual funds that invest in state and local debt.

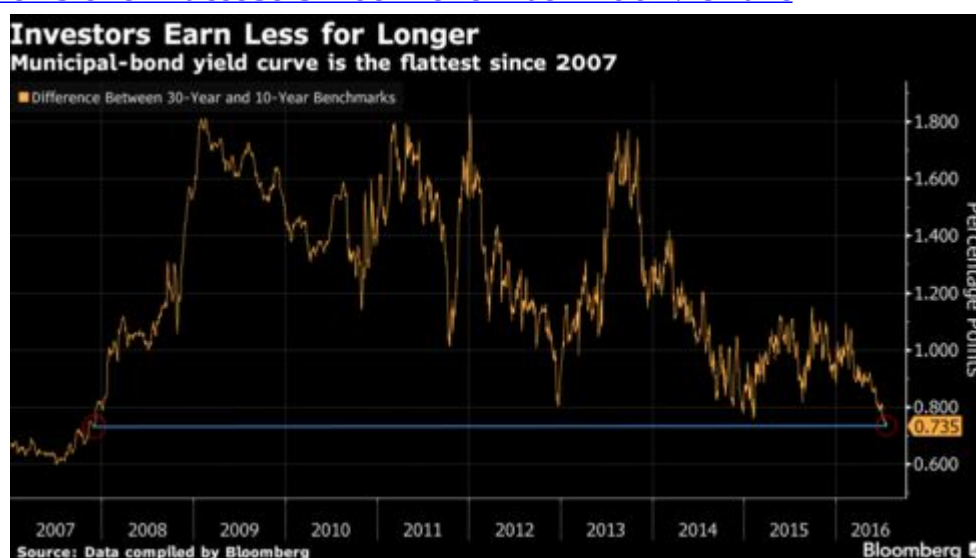
“We can expect outflows when rates increase significantly,” Foux said. “That’s historically what we see.”

Bloomberg Business

by Martin Z Braun

July 22, 2016 — 2:00 AM PDT Updated on July 22, 2016 — 7:09 AM PDT

Muni-Bond Yield Curve Is the Flattest Since November 2007: Chart



The gap between short- and long-term yields in the \$3.7 trillion municipal-bond market is the narrowest in more than eight years. Benchmark 30-year munis yielded 0.735 percentage points more than 10-year securities on Wednesday, the smallest difference since November 2007. This means that investors are earning less for the risk of holding securities with longer maturities.

Bloomberg Business

by Elizabeth Campbell

July 21, 2016 — 7:57 AM PDT

Taper Tantrum Memory Doesn't Fade for MainStay Muni Fund Manager.

MainStay Investments is increasing the percentage of cash held in its municipal bond mutual funds as a hedge against the risk of investor redemptions if the outperforming tax-exempt market turns.

It's \$2.7 billion high yield muni fund has raised its cash level to as much as twice its normal range for liquidity, said David Dowden, a managing director who helps oversee about \$19 billion of local

debt at Princeton, New Jersey-based MacKay Municipal Managers, the fund's sub-adviser. The fund had about 9.6 percent of its portfolio in cash-equivalents as of April 30, the most in two years.

"When everyone suddenly gets all on the same side of the trade, that makes for a very dangerous situation," Dowden said during an interview last week. "That's what we saw in June of '13."

U.S. state and local-governments have taken in cash for 41 straight weeks, according to Lipper U.S. Fund Flows data, as anxiety that the Federal Reserve would raise rates receded and investors sought out the higher tax-adjusted yields and lower volatility than they can find elsewhere. During that period, munis have posted a total return of 5.8 percent, compared with a broader bond market gain of 4.2 percent, according to Bank of America Merrill Lynch index data.

The \$45 billion inflow since October has helped replace the cash lost during the "Taper Tantrum" of June 2013. Investors pulled \$65 billion from muni funds between June 2013 and January 2014 after then-Fed Chair Ben Bernanke jarred bond investors with plans to scale back asset purchases. The broad sell-off in the bond market highlighted a liquidity squeeze in the muni market, which was hit harder than Treasuries. Between June and the end of August 2013, yields on 30-year AAA rated municipal bonds rose almost 1.5 percentage point.

The level of liquidity risk is lower than in 2013. Banks are more willing to step in and buy and investors are less prone to yank money because munis are producing income, said Dowden. The U.K. vote to leave the European Union has lowered the likelihood that the Fed will raise interest rates before the U.S. elections in November. Muni prices rose following "Brexit" as investors clamored to safety.

As the yield curve flattened, Mainstay has focused its buying on bonds maturing from 12 to 25 years rather than long-term debt maturing in 25 to 30 years, which are more sensitive to changes in yields. Mainstay's High Yield Municipal Bond Fund has returned 7 percent this year, beating 77 percent of its peers, according to data compiled by Bloomberg.

"The reality is that incremental yield can be burned away very quickly in a price move," Dowden said.

The market pulled back last week as investors balked at yields that reached record lows and data on manufacturing and retail sales bolstered optimism in the economy. Yields on top-rated 30-year municipal bonds rose to 2.17 percent from 2.09 percent, the biggest weekly increase since February, according to data compiled by Bloomberg.

Some high yield managers are boosting their cash position for a different reason: they can't find securities that offer value in a market that has run-up more than 12 percent in the last year.

"There's so much cash in and everyone's buying because they have to buy," said Matt Dalton, chief executive officer of Rye Brook, New York-based Belle Haven Investments, which oversees \$5 billion of municipal bonds. Belle Haven is the sub-adviser for Transamerica's High Yield Muni Fund, which had had 13 percent of its assets in cash as of April 30.

"We're content with having more cash than we'd like to because of the dearth of opportunities," Dalton said.

Bloomberg Business

by Martin Z Braun

Former Citi Auction-Rate Banker Heeds Lessons of Market Collapse.

At the advent of the financial crisis nearly a decade ago, former Citigroup Inc. banker Robert Novembre, who managed the firm's desks handling auction-rate securities, saw firsthand the disruption caused when banks withdrew support.

Dozens of banks stopped being buyers of last resort for auction-rate securities and variable-rate demand debt, leaving investors with bonds they couldn't sell and borrowers with little control of the interest rates on their debt. The \$200 billion auction-rate securities market shriveled and Citigroup was among the banks that reached settlements with state and federal regulators to resolve claims they misled investors. The variable-rate market limped on in a smaller state.

Now Novembre, 47, plans to apply the lessons to a new alternative trading system for variable-rate debt. Within weeks, his Clarity BidRate Alternative Trading System, a division of Arbor Research & Trading LLC, expects to launch its first variable-rate demand deal as part of an enterprise designed to cut costs for state and local governments by getting bids from investors rather than relying on banks to remarket the debt.

"It's a very antiquated market that functions in the shadows," Novembre said. "But there's a conflict of interest in pricing because the banks are protecting their own balance sheets. Banks aren't pushing down the rates any more because they don't want to own the bonds."

The need for more competition has been shown of late as yields have come off historic lows of about 0.01 percent and soared to about 0.40 percent since the Federal Reserve raised its benchmark rate in December for the first time in almost a decade.

During the height of the market freeze, the weekly re-set rate on the index climbed as high as 7.96 percent.

Despite interest rates that are still low historically, the variable-rate demand market has been shrinking since the collapse of first auction-rate securities and then variable-rate demand obligations after sub-prime contagion brought down insurers and buyers of last resort in the muni market. Many banks and investors were stuck with debt they couldn't sell, while some issuers were forced into costly interest rate penalties and expensive restructuring. The variable-rate market stood at \$222 billion and the auction-rate market was \$27 billion in March 2014, according to the Municipal Securities Rulemaking Board.

Now with rates potentially poised to rise, Moody's Investors Service and others have predicted that borrowers may renew interest in the variable-rate structure to cut borrowing costs. New U.S. Securities and Exchange Commission rules requiring tax-exempt money-market funds to use floating net asset calculations also are encouraging more use of variable-rate debt.

The Securities Industry and Financial Markets Association, which represents banks and broker-dealers, supports the system of remarketing agents that "has served the market well for decades," said Michael Decker, managing director and co-head of the municipal finance division, in an e-mail. He declined to comment specifically on Novembre's company. That said, the association does "welcome market innovations that contribute to efficiency," Decker said.

Novembre, who worked for 18 years for Citi and oversaw about \$170 billion of auction-rate securities, variable-rate demand obligations and tender-option bonds when the variable-rate markets collapsed starting in 2007, said his bank and others were glad to buy bonds to support the markets until it became a risk to their capital. Under variable-rate arrangements, remarketing agents aren't required to buy back the debt but did so voluntarily to support the market.

Trading Platform

With variable-rate demand obligations, issuers pay for so-called liquidity facilities, or buyers of last resort, that buy back the bonds when investors don't want them, something that can happen when the yields are reset.

During the global market turmoil, many buyers panicked and tried to unload the bonds because of fears generated by a freeze in fixed-income markets such as mortgage-backed securities. Following the auction-rate debacle in 2008, variable-rate demand obligations tumbled as buyers faced losses.

"There was a lot of fear," said Novembre. "People quickly started putting the bonds to the bank. The banks were no longer using their balance sheets to support the market."

Today, he said, that is still true because "dealers are loathe to deploy their balance sheets" amid increased regulation since the financial crisis.

By updating the market with an electronic-trading platform that replaces the traditional remarketing arrangement, Clarity is providing a place where buyers and sellers can make bids and offers for bonds that investors don't want to hold with more complete information about the market, he said.

Remarketing Role

"There is too much negotiation involved in setting yields now," he said. "There is an element of human decision making in setting the yields, instead of the actual market place competition."

Under his system, Clarity takes over the remarketing role, but instead of setting rates, buyers and sellers can see all the bids and offers and make their own bids and offers on an on-line trading platform during a remarketing period — up until the period for reselling the bonds closes.

"We take all the subjectivity out of it," he said. "Issuers are put in a position of competitive pricing."

Bloomberg Business

by Darrell Preston

July 18, 2016 — 2:00 AM PDT Updated on July 18, 2016 — 7:32 AM PDT

[Pimco: The Impact of Lower Oil Prices on the Municipal Bond Market.](#)

David Hammer, Head of Municipal Bond Portfolio Management, discusses the impact of lower commodity prices on high yield municipal bonds, and why energy producers may be more concerning than oil revenues.

[Watch the video.](#)

For more information, visit www.pimco.com/munis

DAVID HAMMER

JULY 2016

[Hawkins Advisory: \(Annual Qualified Mortgage Information\)](#)

This Hawkins Advisory is of interest to single-family housing bond issuers.

[Read the Advisory.](#)

7/20/2016

[S&P Global Ratings' Public Finance Podcast \(Higher Education Ratios and PROMESA\)](#)

Shivani Singh and Ashley Ramchandani provide an overview of our recent higher education median reports for public and private colleges and universities. Paul Dyson discusses our take on the impact of the recently-enacted Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) on Guam and the U.S. Virgin Islands.

[Listen to the podcast.](#)

Jul. 22, 2016

[Lessons Learned from Detroit: A Judge's Perspective.](#)

U.S. District Judge Gerald E. Rosen has more experience than most in resolving thorny cases of municipal distress: He was the mediator in the high profile bankruptcy of Detroit. What lessons did he draw from that experience that might apply to future municipal bankruptcies? We put that question to him at our recent Municipal Finance Conference, and he offered what he calls “The Four C’s.”

Candor

“As we began talking to the creditors and to the city...they were in denial across the board...We said denial...is not a way to move forward. We had to go through that ventilation process in the beginning.”

Judge Rosen said he found that both the creditors and the parties were initially unwilling to be honest, with each other and even with themselves. They did not fully accept the dimensions of the structural debt problems and did not recognize the degree to which the city’s ability to fund and deliver essential government services was compromised. Working in a state of denial will not advance the interests of the city, he said. Openness and honesty are integral to resolving financial

troubles.

Cooperation

“My job as the mediator [was] to get the parties together and the earlier the better.”

After listening to accounts of other cases of municipal distress, Judge Rosen suggested that some crises could have been avoided with earlier “facilitation of discussion between the various credit groups and the municipalities.”

Creativity

“Every city has human assets, every city has physical assets, every city has revenue assets, so focus on creative ways to leverage those assets.”

Detroit struck a “grand bargain” in which the city essentially sold the Detroit Art Museum to a collection of foundations, nonprofits and other donors to raise money for its underfunded pensions. Judge Rosen said that was just one of several creative elements in Detroit’s bankruptcy resolution. Of course, the exact solutions to any particular crisis will depend on the circumstances, but the essential element is that “smart people who can get on the same team and look down the road, not just to get their piece of the pie, but to make the municipality healthy so there will be a bigger...pie at the other end.”

Courage

“Detroit is really not [just] a series of deals over sixteen months....it’s about people from all different walks of life, backgrounds, strata, coming together to put behind them the mistakes and ghosts of the past.”

The Detroit bankruptcy, he said, could have resulted in a decade of litigation that went all the way to the U.S. Supreme Court. But if that had occurred, there would have been nothing left of Detroit. Instead, all the interests came together to “take a leap of faith” to find a solution that was in the best, long-term interests of the city, its creditors, its employees and its people.

[Here’s a video of Judge Rosen’s remarks.](#)

The Brookings Institution

Evan Bursey and David Wessel | July 20, 2016 9:24am

[GASB Survey on Indicators of Severe Financial Stress.](#)

The Governmental Accounting Standards Board (GASB) is currently conducting research on indicators of severe financial stress and going concern disclosures. As part of their research effort, the GASB has developed an online survey to solicit thoughts and ideas.

The survey will be open until Friday, August 5, and may be accessed [here](#).

Fed's Final Treatment of Municipal Securities as High-Quality Liquid Assets Disappoints the Industry: Butler Snow

Treatment of Municipal Securities in Fed's Final HQLA Rule Draws Unenthusiastic Industry Reactions

On April 1, 2016, the Federal Reserve Board released its final regulations[1] respecting treatment of municipal securities as high-quality liquid assets ("HQLA") for purposes of its liquidity coverage ratio rule for "covered companies" - the 11 most highly capitalized United States banks - after strenuous criticism from the municipal securities industry and a Congressional response that included a bill that has passed in the House of Representatives[2]. In the final rule, the Federal Reserve Board revised the original proposal by modestly expanding those municipal securities that would qualify for inclusion in a covered company's HQLA, but rejected most commenters' recommendations. The following discussion summarizes the original Fed proposal, the principal comments from affected trade groups, the final regulation, the Fed's rationale for its determinations and the pending legislation.

Financial Crisis and Bank Regulatory Response

In the aftermath of the financial crisis of 2008 and 2009, international banks sought to ensure sufficient liquidity for the largest banks by establishing a quantitative liquidity coverage ratio standard pursuant to the Basel III capital and liquidity reforms. United States bank regulators, including the Board of Governors of the Federal Reserve System (the "Fed"), the Office of the Comptroller of the Currency (the "OCC"), and the Federal Deposit Insurance Corporation (the "FDIC") published a joint Notice of Proposed Rulemaking (the "NPR"), adopted on September 3, 2014[3], that established a Liquidity Coverage Ratio ("LCR") to be maintained by larger banks and holding companies[4]. The LCR would require covered institutions, during periods of non-stress, to maintain an amount of high-quality liquid assets that is not less than 100% of its total net cash outflows over a prospective 30 calendar day period.

Significantly for municipal securities issuers and the municipal securities industry, securities issued by "public sector entities" (*i.e.*, state and local government issuers) were not included as HQLAs in the original NPR.

Objections to NPR and Subsequent Fed Proposal

After predictable objections from trade groups representing municipal issuers, banks and the municipal securities industry, based upon potential harm to municipal securities issuance from exclusion of municipal securities as eligible HQLAs under the NPR, on May 28, 2014, the Fed (but without participation by the OCC or the FDIC) issued a proposal (the "Fed Proposal") that would permit covered institutions to include certain U.S. municipal securities as HQLAs under strict criteria described below.

The Fed Proposal

The Fed Proposal limits eligibility of U.S. municipal securities to investment grade general obligations that are not insured. Revenue obligations, irrespective of credit standing, would not qualify as HQLAs[5]. Additionally, the Fed Proposal imposes significant concentration risk limitations on a covered institution's holdings of HQLA-eligible U.S. municipal securities:

- No more than 25% of an individual CUSIP may be included in a bank's stock of HQLA;

- No more of a single issuer's bonds than an amount equal to two times the average daily trading volume of that issuer's bonds over the previous four quarters may be included in a bank's stock of HQLA; and
- No more than 5% of a bank's total stock of HQLA may be comprised of municipal securities.

Issuer and Industry Comments

During the public comment period on the Fed Proposal, which ended July 24, 2014, the Fed received 13 comment letters from issuers and industry groups[6]. All commenters argued that the HQLA standards for municipal securities in the Fed Proposal were excessively limiting, with the exception of Better Markets, Inc., which argued that municipal securities should not be included in HQLAs at all because of the provision in the Fed Proposal that leaves the determination whether a security is "investment grade" to the covered institution itself.

A primary objection from all trade group commenters – including the Securities Industry Finance and Marketing Association ("SIFMA"), the Bond Dealers Association ("BDA") and a joint comment from 15 issuer groups that included the Government Finance Officers Association, the National Association of Counties, the National League of Cities and the U.S. Conference of Mayors – was the exclusion of investment grade revenue obligations from HQLA eligibility. Specifically, SIFMA noted that the credit quality of many revenue obligations is regarded by the market as preferable to general obligations, particularly in light of adverse treatment of general obligations in recent municipal bankruptcies such as Detroit's. Indeed, the PFM Group noted that the Fed Proposal "reduces the universe of outstanding eligible municipal securities by more than \$2 trillion." Likewise, the Bond Dealers Association noted that the exclusion of revenue securities from HQLA effectively limits the municipal securities that would be eligible for inclusion as HQLA to less than 40% of securities issued in 2015.

Commenters, including municipal bond insurer Build America Mutual Assurance Company, also criticized the exclusion of insured general obligations from the HQLA eligibility, arguing that the Fed Proposal misconceived the role of bond insurance of otherwise investment grade obligations, which does not substitute for the underlying credit and actually adds liquidity to such securities.

Regarding the concentration risk limits in the Fed Proposal, commenters argued that they are based on misunderstandings of the municipal market. With regard to the limitation to 25% of a pertinent CUSIP (i.e., maturity), commenters argued that the rule would push banks to hold many smaller portions rather than large-block portions that are more liquid because of their appeal to institutional investors. SIFMA argued that the 25% limit is actually counterproductive to liquidity and that, alternatively, this rule should be dropped "in favor of reliance on the risk management systems banks already have in place."

Regarding the two-times average daily trading volume limitation, SIFMA noted that historic trading volume may not be the best indicator of liquidity in that many bonds are bought as buy-and-hold investments.

Regarding the limitation of U.S. municipal securities to not more than 5% of a bank's total HQLA, SIFMA noted that no other asset class eligible for inclusion in HQLA, including corporate securities, has an asset-specific limitation. Additionally, the LCR rule separately limits 40% of total HQLA for Levels 2A and 2B combined and has a 15% limit for Level 2B. Thus, SIFMA argued that the existing limitations are sufficient without the addition of the 5% limit.

Pending Legislation

In response to dissatisfaction with the Fed Proposal and the non-participation of the FDIC and OCC in establishing uniform HQLA standards, Representative Luke Messer (R-Ind.) and co-sponsor Representative Carolyn Maloney (D-NY) introduced legislation that would require the Fed Rule “to treat a municipal obligation that is both liquid and readily marketable (as defined in the Final Rule) and investment grade as of the calculation date as a high-quality liquid asset that is a level 2A liquid asset.” The legislation would also require the FDIC and the OCC to conform their HQLA regulations to this statute. The proposed legislation passed the House of Representatives on February 1, 2016, as H.R. 2209 and has been referred to the Senate. As of this writing, there is no Senate sponsorship.

The Final Fed Rule and the Fed’s Rationale; Industry Disappointment

The final Fed Rule makes two basic changes to the Fed Proposal: First, general obligation municipal securities insured by a bond insurer may count as Level 2B liquid assets as long as the underlying municipal security would otherwise qualify as HQLA without the insurance. Second, the final Fed Rule eliminates the 25% limitation on the total amount of outstanding securities with the same CUSIP number that could be included as Level 2B liquid assets. Notably, the final Fed Rule continues to exclude revenue obligations from HQLA status. A summary of the Federal Reserve Board’s rationale for the final Fed Rule is set out in the following footnote[7] .

The final Fed Rule will take effect on July 1, 2016.

In interviews with The Bond Buyer[8], Congressional and trade group spokespersons expressed disappointment in the final Fed Rule. Representative Luke Messer said “Unfortunately, [the rule changes] will continue to discourage investment in our local communities. And, it will do little, if anything, to help cash-strapped school districts and municipalities finance critical infrastructure projects.” John Vahey, Director of Federal Policy at Bond Dealers of America, observed that it is “unfortunate that the Fed has chosen to continue to restrict and limit the use of general obligation bonds and completely exclude high-quality revenue bonds from the banking liquidity rule.”

Potential Impact of the Final Fed Rule? Prospects for a Legislative Override?

What, then, will be the impact of the Fed Rule as adopted? On the one hand, indications are that the HQLA limitations will reduce demand for U.S. municipal securities for covered banks and thus result in increased interest rates for securities bought by covered banks. Also, the continuing absence of a joint regulation that includes the OCC and the FDIC could result in differential standards that could disrupt the market even further. However, since the Fed Rule, as finally adopted, will directly affect only a dozen or so of the largest U.S. banks, it is unknown whether the ultimate Fed HQLA standards will affect non-covered bank lenders and the bond market generally[9].

In light of the passage of House Resolution 2209, the matter is not fully resolved. Whether House Resolution 2209 gains a Senate sponsor and can pass during this election year (not to mention the possibility of a Presidential veto) is speculative, but the industry response to the Fed’s action on HQLA may not be finished yet.

by E. Alston Ray and Caitlyn T. Smith

July 14, 2016

Footnotes

[1] 81 Fed. Reg. 21223 (April 11, 2016).

[2] H.R. 2209, passed February 1, 2016.

[3] 79 Fed. Reg. 61439 (October 10, 2014).

[4] U.S. banks currently meeting the criteria for “covered companies” under the Basel III standards are as follows: J.P. Morgan Chase & Co., Bank of America, Citigroup, Wells Fargo & Co., Goldman Sachs Group, Morgan Stanley, U.S. Bancorp, Bank of New York Mellon, PNC Financial Services Group, Capital One, HSBC North America Holdings, State Street Corporation, and TD Bank U.S. Holdings.

[5] The LCR divides HQLA into three categories of assets: Level 1, Level 2A, and Level 2B liquid assets. Specifically, Level 1 liquid assets are limited to balances held at a Federal Reserve Bank and foreign central bank withdrawable reserves, all securities issued or unconditionally guaranteed as to timely payment of principal and interest by the U.S. government, and certain highly liquid, high credit quality sovereign, international organization and multilateral development bank debt securities. Level 1 liquid assets, which are the highest quality and most liquid assets, may be included in a covered company’s HQLA amount without limit and without haircuts. Level 2A and 2B liquid assets have characteristics that are associated with being relatively stable and significant sources of liquidity, but not to the same degree as Level 1 liquid assets. Level 2 liquid assets include obligations issued or guaranteed by a U.S. government-sponsored enterprises (GSE) and certain obligations issued or guaranteed by a sovereign entity or a multilateral development bank that are not eligible to be treated as Level 1 liquid assets. The LCR subjects Level 2A liquid assets to a 15% haircut and limits the aggregate of Level 2A and Level 2B liquid assets to no more than 40% of the total HQLA amount. Level 2B liquid assets, which are liquid assets that generally exhibit more volatility than Level 2A liquid assets, are subject to a 50% haircut and may not exceed 15% of the total HQLA amount. Under the LCR, Level 2B liquid assets include certain corporate debt securities and certain common equity shares of publicly traded companies. Level 2 liquid assets, including all Level 2B liquid assets, must be liquid and readily marketable as defined in the LCR to be included in HQLA. Under the LCR final rule, U.S. municipal securities were not included in the definition of HQLA. However, under the final Fed Rule all U.S. municipal securities that qualify as HQLAs will constitute Level 2B liquid assets.

[6] All public comments to the Fed Proposal are available on the Fed website at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>.

[7] In its summary of the final rule, the Federal Reserve Board offered the following rationale for its determinations (emphasis added):

a) Certain US municipal securities may be included as a **level 2B liquid asset** if they meet the liquid and readily marketable standard in the LCR rule

i) These securities will not be included as a level 2A liquid asset

b) Revenue bonds **still are not** eligible for inclusion as a level 2B liquid asset:

i) During periods of significant stress, the credit equality of revenue bonds tends to deteriorate more significantly than general obligation bonds.

ii) During times of significant stress, probability of default is considered along with the magnitude of expected loss upon default. Without general taxing authority support, the market would likely be more concerned about the probability of default for a revenue bond as compared to a general obligation bond.

iii) Historically, there have been a significantly higher number of defaults on revenue bonds

than general obligation bonds.

iv) Liquidity could disappear if the specified revenue source of a revenue bond were found to be insufficient to meet its obligation, regardless of the total amount of the revenue bond outstanding.

c) A Board-regulated covered company **may include** as a level 2B liquid asset a US general obligation municipal security that has a guarantee from a financial institution as long as the company demonstrates that the underlying US general obligation municipal security meets all of the other criteria to be included as level 2B liquid assets without taking into consideration the insurance.

d) The final rule **retains** the limitation on the inclusion of US general obligation municipal securities of a single issuer. A Board-regulated covered company that owns more than 2x the average daily trading volume of all US general obligation municipal securities issued by a public sector entity may include up to 2x the average daily trading volume of such securities as eligible HQLA:

i) The Board believed that this 2x average daily trading volume cap could likely be absorbed by the market within a 30 calendar-day period of significant stress without materially disrupting the functioning of the market.

ii) The Board believed that this requirement ensures that US general obligation securities included as eligible HQLA remain relatively liquid and have buyers and sellers during periods of significant stress.

e) The final rule **retains** the 5% limitation on the amount of US municipal securities that can be included in a Board-regulated covered company's HQLA amount:

i) The Board believed this limit will act as a backstop to address the overall liquidity risk presented by the municipal securities market, including the large diversity of issuers and sizes of issuances by ensuring covered companies' HQLA amounts are not overly concentrated in and reliant on US municipal securities.

f) The final rule **eliminates** the 25% limitation on the total amount of outstanding securities with the same CUSIP number that could be included as level 2B assets:

i) This limitation could have barred certain companies from including certain municipal securities, and particularly small issuances, in their HQLA amount.

[8] "Fed Rule Treating More Munis as HQLA Seen As Too Restrictive," *The Bond Buyer*, April 1, 2016.

[9] Many thanks to Belinda Hannah at First National Banker's Bank in Birmingham, Alabama, and Alan Ganucheau, Greg Brewer, Jason Thomas and Steve Cole at Hancock Bank, for taking the time to discuss the Fed Proposal and its potential impact on the municipal securities market. However, nothing in this post is attributable to them or their employers, and, of course, any errors in this post are my own.

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Assured and Orrick Retain Top Insurance, Counsel Ranks in Q2, First Half.

Assured Guaranty topped the rankings of municipal bond insurers for the second quarter while Orrick Herrington & Sutcliffe LLP was the leading bond counsel.

Quarterly League Tables

Muni issuance is only a little behind last year's pace but bond insurance penetration fell to 5.59% in the second quarter from 5.87% in the first quarter to land at 5.85% for the first half. Overall, the principal amount wrapped by Assured, Build America Mutual, and National Public Finance Guarantee - the three insurers writing new business - decreased to \$12.79 billion for the first half of this year over 970 transactions, down from the \$14.36 billion in 1,084 transactions during the first half of 2015, according to data from Thomson Reuters.

Assured retained its first place perch, despite having a lower principal amount insured and fewer deals with \$6.84 billion in 464 deals from \$8.75 billion in 594 deals, while also seeing its market share slip to 53.5% from 61% percent. The data includes Assured's subsidiary Municipal Assurance Corp.

"During the second quarter of 2016, Assured Guaranty continued to lead the industry, insuring 267 small, medium and large new issues, which represented 53% of the insured par sold in the primary market. Our \$3.8 billion of primary-market par was up 25% from the first quarter of 2016," said Robert Tucker, senior managing director, investor relations and communications at Assured.

Tucker also mentioned that looking at Assured's first-half 2016 primary market activity, they captured a similar 53% of the market by guaranteeing \$6.9 billion of par.

"Our secondary-market activity for the half of 2016 was very strong," Tucker said. "We issued 234 policies, totaling an industry-leading \$752 million of par, 87% higher than in the first half of 2015. Our combined primary and secondary market par insured during the first half totaled \$7.6 billion."

BAM also saw increases, as its principal amount insured rose to \$5.59 billion in 468 issues from \$5.29 billion in 479 issues. Although the mutually-owned company didn't do as many deals during the first six months of 2016 compared to the same period in 2015, they did see an increase in market share, improving to 43.6% from 36.9%.

"BAM had a great first half and a record second quarter, when our primary market par insured exceeded \$3 billion for the first time," said Bob Cochran, BAM's chairman. "We got there by staying focused on our core mission of improving market access and transparency, particularly for small- and medium-sized issuers, and expanding investor demand for our guaranty."

Cochran also said that they are definitely seeing a growing awareness of the unique benefits BAM brings to a transaction as a mutual insurer, which he said includes its excellent financial strength and durable, AA/stable rating, as well as the additional transparency it provides for every insured bond by publishing a free credit profile on its website.

"The increased investor demand for BAM-insured paper was particularly obvious in our secondary market activity, which totaled almost \$260 million in 190 trades in the second quarter, more than doubling volume from both the first quarter of 2016 and the second quarter last year," Cochran said.

National also had a better first half this year compared to last year, as its amount insured increased to \$367 million over 39 transactions from \$309 million in 11 transactions.

"In light of the ongoing difficult environment for our industry - with extremely low interest rates and the uncertainty regarding the outcome for Puerto Rico - we are pleased that investors continue to express demand for bond insurance," said Tom Weyl, head of new business development at National.

The municipal arm of MBIA Inc., which started writing new business in the third quarter of 2014, saw its market share inch up to 2.9% from 2.1%.

"We are also pleased with National's steady progress. We are gaining greater attention from important parties in the market that will further our progress, especially as market conditions become more favorable," said Weyl.

In the bond counsel rankings, Orrick not only held its first-place position but extended its lead, as the firm finished the first half of 2016 with a par amount of \$22.12 billion or 10.4% market share in 217 transactions, an improvement over the \$20.69 billion or 9.7% market share in 205 transactions during the first six months of 2015.

"We are obviously happy with our firm's results for the first half of 2016," said Roger Davis, chair of Orrick's public finance practice. "The national market volume was down by about 4% compared to the first half of 2015. Orrick's volume was up by about 9%, and our market share jumped by almost two full percentage points to over 10%."

Davis said that persistent low interest rates, accompanied until recently with the threat of rate increases by the Federal Reserve, led to a large number of refundings.

"And on top of that, we saw increasingly robust new money financing activity, particularly in multifamily housing, health care, public and charter schools, energy (including alternative and distributed energy), even governmental purpose (general fund and enterprise revenue) projects, all sectors in which Orrick is particularly strong," said Davis.

Davis also noted that the office Orrick launched in Houston in January has been busy from inception is a substantial new contributor to the firm's public finance group and its results.

"Looking ahead, we are as busy in all of our nine public finance offices around the country as I can remember being during the summer months," said Davis.

Hawkins Delafield & Wood LLP stayed in second place with \$11.09 billion or 5.2% market share over 173 deals, all slightly down from the \$12.41 billion or 5.8% market share over 225 deals the firm finished with during the same period of time last year.

McCall Parkhurst & Horton LLP saw increased year over year, as the firm moved up to third from fourth place, finishing the half with \$8.48 billion in 264 transactions versus \$7.89 billion in 251 transactions.

Norton Rose Fulbright dropped from third to fourth to \$6.87 billion from \$9.69 billion, while Kutak Rock LLP moved up one spot into the top five with \$6.14 billion from \$6.10 billion.

Rounding out the top 10 are Squire Patton Boggs, Chapman and Cutler LLP, Stradling Yocca Carlson & Rauth, Sidley Austin LLP and Bracewell LLP.

The two biggest movers from the first half are Chapman and Cutler LLP, who jumped up to seventh from 15th a year ago and Bracewell LLP who leaped into the top 10 after finishing 16th during the first half of 2015.

Hawkins held the top underwriters counsel spot and pushed its lead further, finishing the first half of 2016 with \$13.75 billion or 9.2% market share in just 65 deals, which compared to \$10.58 billion or 7.1% market share in 83 deals in the first six months of 2015.

“For Hawkins in the first half of 2016, we had strong results across the board in terms of sectors and geography,” said Howard Zucker, managing partner at Hawkins. “This is due to having more lawyers devoted to the full-time practice of public finance than any other law firm in the nation, including 14 tax attorneys. Hawkins is 162 years old, and has been doing public finance for over 135 years but we know that we cannot rest on our laurels—we understand that we have to come to work each and every day to earn and deserve the trust and confidence of our clients.”

Zucker added that among the many deals in which Hawkins participated in that were noteworthy, the firm was counsel to the underwriters in the \$2.4 billion dollar bond issue for the rebuilding of LaGuardia Airport that was a P3 transaction, and bond counsel for the refunding of bonds of the NYS Utility Debt Securitization Authority. In addition, Hawkins was also involved in several large transactions for the State of California, and many housing and hospital financings around the nation.

“After the bankruptcy of, among others, the City of Detroit, and the Federal enactment of legislation to address the financial situation in Puerto Rico, there is much more attention to the legal structure of transactions, including statutory liens and special revenues, and that requires expertise in bankruptcy and secured transactions,” said Zucker. “This is another example of the requirement that bond lawyers have the necessary expertise in multiple areas of the law.”

Hawkins opened its ninth office in Michigan last fall and as of Jan. 1, the firm added three partners to its ranks.

“We look forward with excitement to the future of public finance,” said Zucker.

Norton Rose Fulbright finished second with \$8.02 billion, Stradling Yocca Carlson & Rauth was in third with \$6.41 billion, Kutak Rock LLP came in fourth place with \$5.78 and Nixon Peabody LLP was fifth with \$5.75 billion.

Rounding out the top ten are Orrick, Squire Patton Boggs, Andrews Kurth LLP, Bracewell LLP and Greenberg Traurig LLP.

The biggest jump belonged to Bracewell LLP, who finished the first half of last year in 21st place and moved up to ninth this year.

“The trend for many years has been for greater specialization in the bond legal practice. This is a reflection of the increased complexity of municipal bond issues, the highly extensive regime of federal tax regulations, as well as the heightened disclosure expectations of the market and of the SEC,” said Zucker.

Zucker also noted that today law firms that want to be leaders in this field have to be truly dedicated, and have to commit significant resource to the depth and breath of expertise in order to be able to advise issuers and others in the navigation of the matrix of issues across the full range of sectors of public finance.

The Bond Buyer

By Aaron Weitzman

July 20, 2016

City, County Leaders: U.S. Infrastructure Policy Must Protect Tax-Exempt Bonds, Enhance Long-Term Funding.

CLEVELAND, July 21, 2016 /PRNewswire/ — Republican elected officials from across the nation explained how infrastructure investments have fueled growth in their local economies, and said those successes support the case for more federal resources for infrastructure, as well as the preservation of tax-exempt municipal bonds in any tax-reform legislation. Their comments came during a policy briefing at the Republican National Convention sponsored by the National League of Cities (NLC), the nation's largest and most representative organization for city officials, and Build America Mutual (BAM), the first mutual insurer of municipal bonds.

Hon. Ray LaHood, a Republican who represented Illinois' 18th Congressional District for 14 years before being named Secretary of Transportation in 2009, opened the session by arguing that the federal government should raise the gas tax to generate more money for infrastructure investment — particularly focused on urban areas.

"The next generation of transportation is going to take place in the cities. It's not about building more Interstates or bridges, it's about how people are going to live in communities without needing automobiles," Secretary LaHood said. "Until we get politicians in Washington and a new administration thinking along the lines of a big pot of money to jumpstart these opportunities, we're selling ourselves short."

Clarence Anthony, NLC's CEO and executive director, said preserving the tax-exemption for municipal bonds, which cuts the cost of infrastructure investment for states, cities, counties and other municipal governments, is a key priority for local government leaders. The tax exemption must come alongside long-term, stable funding for infrastructure and transportation, comprehensive transportation planning, and support for local broadband access.

"We are going to both the Republican and Democratic conventions because cities need to be partners with the next president of the United States, whoever that will be. We need the candidates to understand that we must make infrastructure a priority for America," Mr. Anthony said. "Cities are a crucial part of that conversation because when cities succeed, the nation succeeds."

BAM Chairman Robert Cochran said the tax-exempt municipal bond market is uniquely positioned to provide U.S. states, cities, counties and other government agencies with affordable funding to meet the nation's infrastructure needs.

"There is no doubt that there is municipal market demand and investors that will provide that additional \$100-\$150 billion of annual investment that it will take to get to that \$1.5 trillion of infrastructure funding that we need in order to make up the gap over the next 10 years," Mr. Cochran said.

Additional panel participants included Oklahoma City Mayor Mick Cornett, the president of the US Conference of Mayors; Fort Worth, Tex., Mayor Betsy Price, who co-chairs the NLC's presidential elections task force; El Paso County, Colo., Commissioner Sallie Clark, president of the National Association of Counties; and Sheila Amoroso, who manages the municipal bond department at Franklin Resources, one of the largest investors in municipal bonds.

Build America Mutual

July 21, 2016

About the National League of Cities

The National League of Cities (NLC) is dedicated to helping city leaders build better communities. NLC is a resource and advocate for 19,000 cities, towns and villages, representing more than 218 million Americans. www.nlc.org.

About Build America Mutual

BAM is the first mutual insurer of municipal bonds and the leading insurer of new-issue municipal bond transactions. BAM's members are the more than 2,000 municipal bond issuers - including cities, counties, school districts and utility systems nationwide - who have used BAM insurance to save more than \$300 million on their infrastructure investments since 2012. To improve transparency in the municipal market, BAM publishes a Credit Profile for every transaction it guarantees, which can be downloaded for free at www.buildamerica.com/credit-profiles. BAM-insured bonds are rated AA with a stable outlook by S&P Global Ratings.

[Bill to Raise Issuer Limit For Bank-Qualified Bonds Offered in Senate.](#)

WASHINGTON - Two Senators have introduced a companion bill to a measure in the House that would permanently raise the annual issuer limit for issuers of bank-qualified bonds to \$30 million from \$10 million.

The Municipal Bond Market Support Act of 2016 (S. 5237) was introduced by Sen. Bob Menendez, D-N.J. and referred to the Senate Finance Committee on Thursday. The bill is cosponsored by Sen. Ben Cardin, D-Md., who is a member of the Senate Finance Committee's taxation and IRS oversight subcommittee.

It is an identical version of The Municipal Bond Market Support Act of 2015 (H.R. 2229), which was introduced in the House in May of last year by Rep. Tom Reed, R-N.Y. That bill is pending before the House Ways and Means Committee.

Menendez and Cardin could not be reached for comment Wednesday.

The companion bills would raise the annual issuer limit to \$30 million permanently for the first time since bank-qualified bonds were created in 1986. The legislation would also index the annual issuer limits to inflation and apply to 501(c)(3) nonprofit borrowers rather than to the issuers they borrow from in conduit deals.

The bill pending in the Senate, if enacted, would greatly benefit many of the smaller, more rural jurisdictions that generally issue bank-qualified bonds to fund infrastructure projects, Emily Brock, director of the Government Finance Officers Association's federal liaison center here told The Bond Buyer on Wednesday.

"This would really benefit a significant number of GFOA members," Brock said, adding that roughly 70% of the organization's members are mid-to-smaller sized jurisdictions. "Smaller jurisdictions often have to pay a premium because of investor unfamiliarity with their area."

Bank-qualified bonds were created under the Internal Revenue Code of 1986 in order to allow smaller issuers to sell their tax-exempt bonds directly to local banks. These bonds give local issuers a chance to bypass the traditional underwriting process and access more cost-effective credit.

Brock said that small issuers often pay higher underwriting costs and also have a tougher time selling their bonds because investors oftentimes are not familiar with their jurisdictions. Selling bank-qualified bonds directly to banks reduces issuance costs by roughly 25-to-40 basis points, according to GFOA's bank-qualified municipals bonds resource center. As a result, GFOA said that many small issuers have been forced to pay higher interest rates.

Under the current threshold, a 25-to-40 basis points savings on a 15-year, \$10 million bond would be between \$232,000 and \$370,000, according to GFOA. The basis points savings on a 15-year, \$30 million bond would range from \$696,000 to \$1.1 million, the group estimates.

Banks can currently deduct 80% of the carrying cost of a qualified tax-exempt obligation under the federal tax code. The carrying cost includes the interest incurred from purchasing or carrying an inventory of securities.

However, Congress in 1986 limited bank purchases by saying banks could only buy the bonds of state and local governments that issue no more than \$10 million of bonds during the calendar year.

Congress temporarily increased the issuer limit to \$30 million in 2009 and 2010 under the American Recovery and Reinvestment Act, but that the increase was not renewed when it expired at the end of 2010.

Other versions of the Municipal Bond Support Act were introduced in the Senate in 2011 as well as in the House in July 2014.

Brock said the \$30 million threshold was reached because the \$10 million level set three decades ago was not tied to inflation. When indexed for inflation, the figure would be roughly \$30 million, she said.

Brock said GFOA will continue to push through grassroots efforts to gain support for the bill, as well as urge more Senators to cosponsor the bill. A letter supporting the Municipal Bond Market Support Act of 2016 was sent to Menendez on June 24 was signed by 14 organizations, including GFOA, Bond Dealers of America and the National Association of Bond Lawyers.

She said she is confident that the bill can garner more support ahead of the next Congress because of the identical bills introduced in both the House and Senate.

"This is a stronger step than we've made in the past," she said. "It allows both houses to see that this is a priority, and it sets the stage for really good conversation. It's definitely a positive step in the right direction."

The Bond Buyer

By Evan Fallor

July 20, 2016

[What Would a Best-Case U.S. Infrastructure Agenda Look Like?](#)

Virtually everyone agrees that the United States needs modern, well-maintained infrastructure to ensure its future prosperity. Platforms produced for both major political parties at their conventions

this month mention the issue, with Democrats pledging to “make the most ambitious investment in American infrastructure since President Eisenhower created the interstate highway system” and Republicans noting that “everyone agrees on the need for clean water and safe roads, rail, bridges, ports and airports.”

Yet financing that infrastructure has become highly contentious. Lawmakers at all levels of government – have different ideas of how much to spend on infrastructure and where that money should come from, and a hesitancy to increase taxes or concerns over spending huge amounts of money on “luxury” upgrades has created political gridlock in many places.

But if the spending were less controversial and the political will were there, the U.S. could substantially transform its infrastructure. The new construction and upgrades could change how Americans travel, strengthen the country’s economic engine, and make our communities safer and happier places to live. Texans might ride a futuristic bullet train to Atlanta, every child might attend a modern well-equipped school, and no city would have to worry about the safety and reliability of its drinking water.

As The Bond Buyer reaches 125 years of covering how America finances its infrastructure needs, we take a look at ten key areas of need and what could happen if money and politics weren’t in the way. We examine what the project is, how it could benefit America, and, importantly, how it could be financed.

INTERSTATE 2.0

What it is:

A total modernization of the interstate highway system with upgrades such as dedicated truck lanes, redesigned interchanges to reduce bottlenecks, and express bus service

How it benefits the country or region:

The new interstate would improve commerce and the quality of life by reducing travel times and creating easier access to major population centers. The existing system was built more than half a century ago during the presidency of Dwight Eisenhower, and in many sections is inadequate for modern traffic needs or becoming aged and unreliable.

How much it costs:

Roughly \$1 trillion

How it gets paid for:

All options on the table, but the most realistic is likely a combination of federal spending driven by user fees such as gas taxes and some local investment. Gas taxes have historically been the major means, but P3s are possible if allowed by the federal government.

AIRPORT INFRASTRUCTURE

What it is:

A radically consolidated ATC system with current control towers replaced by ground-level or underground facilities using an array of airport sensors at large airports, along with expansions and modernizations.

How it benefits the country or region:

Creates a more efficient and safer air travel. Air travel facilitates the movement not only of passengers but also of goods, and is a crucial economic driver for many localities with large or hub

airports.

How much it costs:

Billions, but exact cost depends on the extent of the upgrades. The Federal Aviation Administration is attempting to implement its “NextGen” technological upgrades program, but has said it is dependent on full federal funding for the next 3 years, a political uncertainty.

How it gets paid for:

Federal spending or existing avenues of airport finance, including bonds backed by airport fees. Passenger Facility Charges, fees levied at commercial airports controlled by public agencies, are capped at \$4.50 per passenger and could be raised to produce more revenue.

BRIDGE REPLACEMENT

What it is:

A replacement of structurally deficient and obsolete bridges nationwide. The American Road and Transportation Builders Association estimates that there are 58,495 U.S. bridges in need of repair.

How it benefits the country or region:

Rebuilt bridges are safer and improve traffic flow because they can handle increased weight loads, whereas some older bridges now have had to limit traffic for safety concerns. Bridge replacement could also facilitate expansion of certain highway sections crucial to some local economies.

How much it costs:

Likely over \$150 billion nationwide.

How it gets paid for:

A good P3 candidate because they can be tolled and backed with revenue bonds.

WATER INFRASTRUCTURE

What it is:

A replacement and expansion of America’s existing drinking water infrastructure, much of which is past or approaching its useful life

How it benefits the country or region:

Outdated water infrastructure can be unreliable or even unsafe, as in Flint, Michigan. Water main breaks can interrupt service and cause costly damage.

How much it costs:

The American Water Works Association has estimated it will cost about \$1 trillion through 2035, assuming replacement of the entirety of America’s drinking water system over that time. Drinking water components typically have a 15-95 year useful lifespan.

How it gets paid for:

Local planning and financing is the way to go, as each localities needs are unique. Some communities would pay as they go, others would bond.

NATIONWIDE HIGH SPEED RAIL

What it is:

A nationwide network of trains capable of exceeding 200mph. Such trains are already common in Europe and Asia, but are essentially nonexistent in the U.S. Amtrak operates a “high speed” Acela

service in the Northeast, but its average speeds along its route are considerably slower than other high speed rail services globally.

How it benefits the country or region:

These trains could provide a green, fast way to travel between major metropolitan areas. They could serve as an alternative to air travel for short to intermediate distance trips, such as between Seattle and San Francisco or Houston and New Orleans. The U.S. Conference of Mayors has touted the economic benefits high speed rail would have to cities served by it.

How much it costs:

\$500 billion plus

How it gets paid for:

A combination of federal dollars and local borrowing via bonds. The federal government has shown an interest in helping local governments leverage federal money to build high speed rail infrastructure.

PORT MODERNIZATION

What it is:

A series of improvements to the largest U.S. ports to ensure their continued economic competitiveness. Includes deepening them, adding more land-side cargo infrastructure, inclusion of robotic technologies.

How it benefits the country or region:

Modernized U.S. ports will facilitate more efficient interstate and international commerce, and help prevent port-driven localities from being driven out of business by ports in Mexico or Canada.

How much it costs:

More than \$1 trillion

How it gets paid for:

Port authorities would borrow via bonds backed by their revenues. Port Authorities are already often some of the largest most frequent issuers in the U.S., and many have high credit ratings allowing them to borrow at a low cost.

SCHOOL UPGRADES

What it is:

Getting U.S. K-12 education into good operating condition. Almost half of U.S. public school buildings were built for the baby boom generation born between 1950 and 1969, the American Society of Civil Engineers reports.

How it benefits the country or region:

U.S. schools serve as not only education centers, but also as community gathering places, shelters during disasters, and other important functions.

How much it costs:

\$270 billion plus.

How it gets paid for:

State and local spending, including bonds that could be either general obligations or increasingly-

popular property-tax bonds. The ASCE also recommends exploring alternative financing options and innovative ways to reduce costs. Warren County Kentucky's Richardsville Elementary School, for example, generated enough electricity via solar panels to sell energy back to the grid.

HAZARDOUS WASTE SITE CLEANUP AND REDEVELOPMENT

What it is:

Cleanup and redevelopment of more than 1,000 unsafe brownfield sites. The U.S. produces millions of tons of hazardous waste annually.

How it benefits the country or region:

These sites pose a potential health and safety risk and also can't be turned into useful public sites until they are cleaned up and made safe.

How much it costs:

Roughly an extra \$500 million annually over what the Federal government currently spends. Possibly more than \$200 billion over the next 30 years.

How it gets paid for:

Federal spending through the Environmental Protection Agency's Superfund is the traditional way, but the EPA can also force whoever is responsible to clean up the site in many cases. Localities could partner with the federal government or be incentivized to redevelop these sites locally.

LEVEE REPAIR

What it is:

Repair and replacement of American levees, which protect both farmland and developed areas from flooding. The U.S. has some 100,000 miles of levees in all 50 states and the District of Columbia

How it benefits the country or region:

Insufficient or outdated unreliable levees can fail, causing devastating losses to the communities affected.

How much it costs:

More than \$100 billion.

How it gets paid for:

P3s are a possibility, if surrounding infrastructure or the waterway can be monetized. US Army Corps of Engineers needs additional federal funding, localities must increase investment on levees not the responsibility of the federal government.

NEW AGE ENERGY INFRASTRUCTURE

What it is:

Modernizing and expanding an increasingly outdated and unreliable distribution and transmission network for U.S. power supplies.

How it benefits the country or region:

Outages are a huge blow to the communities affected, slowing business to a crawl and creating a dangerous situation.

How much it costs:

Experts believe there is an investment gap of roughly \$100 billion over the next several years.

How it gets paid for:

Largely local and P3, but federal government can play a role, particularly in incentivizing or helping in the development of green energy infrastructure.

The Bond Buyer

By Kyle Glazier

July 19, 2016

[Senate Introduces Bank-Qualified Loan Legislation.](#)

Last week, a group of Senate lawmakers introduced legislation ([S 3257](#)) that would permanently raise the issuer limit on bank-qualified bonds from \$10 million to \$30 million. The legislation, which breathes new life into the effort to restore the annual issuer limit to \$30 million, is the culmination of work by GFOA's Federal Liaison Center with the offices of Senator Cardin (D-MD) and Senator Menendez (D-NJ).

This legislation is identical to the legislation introduced in the House late last year ([HR 2229](#)), which is a significant step in the right direction—it not only sends a message to both the House and Senate about the importance of raising the bank-qualified loan limit, but it also sets the agenda for what may prove to be an exciting 115th Congress beginning in January 2017.

The Federal Liaison Center encourages GFOA members to reach out to your senators and encourage co-sponsorship on this important legislation. Our [Bank-Qualified Loan Resource Center](#) provides sample letters and other helpful information about the legislation and the history of bank-qualified bonds.

Bank-qualified bonds were created in 1986 to give smaller issuers more cost-effective access to credit by allowing them to bypass the traditional underwriting system and sell their tax-exempt bonds directly to local banks. In addition to the higher costs of issuance in the normal underwriting process, many small issuers have a difficult time selling their bonds because investors may not be familiar with their jurisdictions. Many small issuers have therefore been forced to pay higher interest rates on their bond issuances.

Recognizing the utility of bank-qualified bonds to overcome these cost barriers, Congress temporarily expanded their use by raising the issuer limit to \$30 million annually in 2009, and as a result, the market for bank-qualified bonds increased to approximately \$32 billion that year. However, despite the effectiveness of bank-qualified bonds and bipartisan support on Capitol Hill, Congress did not extend these provisions beyond their December 31, 2010, sunset date, and on January 1, 2011, the annual issuer limit for bank-qualified bonds reverted to \$10 million.

GFOA

Tuesday, July 19, 2016

GASB Equity Interest Ownership Consultative Group Formed.

GASB Chair David A. Vaudt recently announced the appointment of a consultative group to assist with the Board's research examining equity interest ownership of legally separate entities.

The members of the consultative group are:

- Lynne Bajema, Oklahoma State Comptroller, Office of Management and Enterprise Services
- William Bonawitz, Director of Research, PNC Capital Advisors, LLC
- Iain C.W. Briggs, Partner, Spectrum Health Partners, LLC
- Gregory A. Clark, Head of Municipal Research, Debtwire
- Suresh Geer, Executive Director of Finance, Seminole Tribe of Florida
- Greg S. Griffin, State Auditor, State of Georgia
- Demetria V. Hannah, Economic Statistical Methods Division, US Census Bureau
- Duane Hopkins, Chief Financial Officer/Deputy Director, Fort Collins Housing Authority
- Douglas J. Kilcommons, Senior Vice President - National Credit Team Manager, Wells Fargo Bank, N.A.
- Robert C. Kuehler, Associate Vice President/University Controller, University of Colorado
- Kristin Montgomery, Controller, California Public Employees' Retirement System
- John G. Moore, Executive Vice President/Chief Financial Officer, Parkland Health and Hospital System
- Tasha N. Repp, Tribal Services Group Partner, Moss Adams LLP
- Bart Rodberg, Director, RSM US LLP
- Blake Rodgers, Audit Senior Manager, Deloitte & Touche LLP
- Craig D. Shoulders, Professor, The University of North Carolina at Pembroke, Department of Accounting and Information Technology

WHAT DO CONSULTATIVE GROUPS DO?

The GASB assembles consultative groups at the discretion of the GASB chair for pre-agenda research that is expected to be extensive and to address a broad portion of the accounting and financial reporting standards. Consultative groups serve as a sounding board, providing suggestions and feedback to the GASB staff as research activities progress. As part of this process, consultative group members review drafts of research materials prepared by GASB staff, commenting as appropriate.

HOW ARE PARTICIPANTS SELECTED?

Consultative groups are officially appointed by the GASB chair after consultation with the other GASB members and GASB staff. Consultative group members typically have a particular expertise or experience with the issue being researched and also are capable of articulating the views of other, similar constituents.

Members primarily are identified from the GASB's database of stakeholders, including persons who have indicated a willingness to volunteer for a consultative group. The GASB attempts to maintain an appropriate balance of financial statement preparers, auditors, and users on each consultative group.

Within each group, the GASB seeks to include a variety of types of stakeholders, such as finance officers from general purpose governments and business-type activities; auditors in government and private practice; and users from the municipal bond industry, citizen and taxpayer groups,

legislative bodies, and the academic community. The GASB also tries to balance other factors that may be relevant, such as governments of various sizes and geographic areas of the country.

[GASB Survey on Indicators of Severe Financial Stress.](#)

The Governmental Accounting Standards Board (GASB) is conducting a survey on the effectiveness of financial stress indicators of state and local governments. The survey is intended to gather feedback on the following questions: 1) What criteria might achieve the objective of disclosing severe financial stress uncertainties with respect to governments; 2) What information do financial statement users need with respect to the disclosure of severe financial stress uncertainties; and 3) Are the going concern indicators currently presented in note disclosures appropriate for state and local governments under severe financial stress.

The survey can be accessed [here](#) and should be completed no later than Friday, August 5, 2016. If you have any questions, you can contact Amy Shreck of the GASB project team at ashreck@gasb.org. You do not need to complete the entire survey in one session. If you save your responses, you will receive an individualized link that you can use to complete your survey later.

[How the Army Corps of Engineers Is Entering the P3 Market.](#)

DALLAS - A \$2 billion flood diversion project aimed at preventing future natural disasters in North Dakota and Minnesota will be the first public-private partnership for the U.S. Army Corps of Engineers.

The Red River project would protect more than 225,000 residents and \$14 billion of property by moving floodwaters away from Fargo, N.D., and other areas that suffered from a massive flood in 2009 that nearly inundated the region.

The project includes a channel that is 36 miles long and a quarter-mile wide, two aqueducts, four railroad bridges, four interstate highway bridges, and 10 county road bridges.

The partnership agreement for the diversion project was signed July 11 by Lowry Crook, deputy assistant secretary of the Army for civil works, as well as the mayors of Fargo, N.D., and Moorhead, Minn., and the directors of the Fargo-Moorhead Flood Diversion Authority.

The Red River has flooded the area 49 times in the past 110 years, including every year from 1993 to 2011 and again in 2011. Another major flood could cause more than \$10 billion of damages, said diversion authority chairman Darrell Vanyo.

The agreement formalizes the federal government's \$450 million contribution to the \$2 billion project and paves the way for a formal request from the Diversion Authority next month for qualification from interested private partners.

The Red River project will be the Army Engineers' first P3 test, said Corps commander Lt. Gen. Thomas P. Bostick.

The Water Resources Reform and Development Act of 2014 (PL 113121) required the Army

Engineers to create a pilot P3 program with up to 15 projects.

"We can't wait. The nation can't wait," Bostick said. "Finding a way to think creatively about funding these projects is very important."

Private investors are necessary because Congress provides only \$1.5 billion a year to fund \$23 billion of Corps' projects, he said.

"For the Corps, we've hired people who wake up every day and their number one mission is to think about public-private partnerships and [how] to move them forward," Bostick said.

North Dakota and its local governments will provide \$1.2 billion to build the project, with \$175 million of state funds already committed. Minnesota, which will receive fewer benefits from the project than its neighbor, will contribute up to \$100 million.

The local governments will fund most of their share of the project costs with proceeds from revenue bonds supported by a dedicated 0.5% sales tax already approved by voters in Fargo and Cass County, N.D., said county administrator Keith Berndt.

The private partner is expected to provide up to 20% of total project costs.

The Flood Diversion Authority intends to use local sales tax revenues and state funds to make annual availability payments to the selected concessionaire.

The private partner that would be selected in 2017 would be responsible for financing its share of the project, building the required infrastructure, and operating the diversion facility for up to 35 years.

The Army Engineers will build a 12-mile dam on the Red River to direct floodwaters into the diversion channel through a conventional design/build approach, said Corps project manager Terry Williams.

It would take 20 years or more for the Corps to complete the entire project without the private partners because its federal funding comes in annual installments that are not consistent, Williams said.

"They may be able to find more innovative ways to design and build it knowing that they are going to have this operation and maintenance," she said. "They may be willing to take a little more risk than the Corps would if we were designing and building it."

The Bond Buyer

By Jim Watts

July 13, 2016

[On Politically Tricky Transit Projects, Many Cities Let Voters Weigh In.](#)

Cities nationwide have crafted and acted on ambitious blueprints for light-rail and other forms of mass transit, but unlike the Twin Cities, many of them have asked their voters whether they want higher taxes to help pay for it.

Ballot initiatives “give local officials the ability to turn a tricky political decision over to the voters,” said Jason Jordan, executive director of the Center for Transportation Excellence, a Washington, D.C., group that tracks transit spending. Since 2000, transportation initiatives have been on the ballot in 41 states, with an average of 71 percent passing.

A referendum of this sort has not been considered in Minnesota because the Legislature would have to authorize it. And, since efforts to pass a half-cent metro sales tax for transportation were thwarted by light-rail-averse Republicans last spring, that seems unlikely.

The final piece of local funding for the \$1.79 billion Southwest light-rail line, totaling \$135 million, is now in doubt. The fate of close to \$900 million in federal matching funds for the controversial project is murky as well.

Partisan politics over mass transit haven’t necessarily played out nationally the way they have in Minnesota, according to Jordan. “We have found no partisan connection with these [transit] measures at all,” he said. “Voters really have a chance to evaluate whether they believe there’s value in a project or not.”

This fall, Seattle-area residents will vote on an initiative called Sound Transit 3 that calls for new sales and property taxes to fund \$53.8 billion in transportation projects, including 62 additional miles of light rail.

Voters in the car-clogged Los Angeles area will decide in November whether to increase a county sales tax by half a cent for the next 40 years, raising about \$120 billion to expand mass transit and various transportation initiatives.

Other cities, including Dallas, Phoenix and Denver, have used voter-approved tax revenue to build transit systems that are far more expansive than the Twin Cities’, which at the moment has two light-rail lines spanning 23 miles.

Dallas, Texas’ third-largest city, boasts a \$5 billion light-rail network that is the longest of its kind in the country with some 90 miles of track. Last summer, Phoenix voters approved a \$31.5 billion transportation plan for the next 35 years that includes a transit sales tax increase to 0.7 percent. The funds will help build 42 miles of light rail.

In Denver, a city often seen as a peer to the Twin Cities, voters in 2004 approved the \$4.7 billion FasTracks program, which added 122 miles of new commuter and light-rail lines in the region, as well as bus-rapid transit (where buses operate like trains) and related infrastructure.

However, Denver discovered the hard way how sales taxes ebb and flow with the economy. Once the Great Recession hit, costs of the transit program ballooned to nearly \$7 billion, leaving a budget gap of \$2.2 billion. A unique public-private partnership involving local businesses stepped in to help fund several rail lines, including one connecting Union Station in downtown Denver to the Denver International Airport.

Now back on track, transit options in Denver have been crucial in attracting millennials to the city, as well as \$5.5 billion in transit-oriented development, said Nate Currey, spokesman for the Regional Transportation District. “You do not have to have a car to live here,” he said, adding that aging baby boomers are shedding their wheels, too.

Transit “is a big economic competitiveness issue for us to compete as a region,” said Adam Duininck, chairman of the Metropolitan Council, the regional body in the Twin Cities that plans and operates transit. “When you look at how we compare to other regions, we do well in all areas except for

transit.”

There is a little-known transit sales tax in the metro area that has played a key role in funding big projects, such as the nearly \$1 billion Green Line, linking the downtowns of Minneapolis and St. Paul.

Since 2008, five Twin Cities metro counties — Hennepin, Ramsey, Washington, Anoka and Dakota — have used the quarter-cent sales tax and a \$20 motor vehicle sales tax to invest in transit projects administered by a group of mostly elected officials called the Counties Transit Improvement Board (CTIB). And 10 years ago, a general referendum question passed by voters dedicated 40 percent of motor vehicle sales tax proceeds to transit over a five-year period.

But Dakota County, unhappy with its return from the transit tax, voted last month to leave the group, and other suburban counties may follow.

If cities are unable to raise local money for big transit projects like light rail, they are in danger of losing matching dollars from the Federal Transit Administration. The FTA’s New Starts program, which pays out about \$2.3 billion a year for new light rail, commuter rail and bus-rapid transit projects costing more than \$250 million, looks first for a local funding commitment before awarding its grant money.

The competition for FTA money is fierce, transit experts say.

“You snooze, you lose,” said Hennepin County Commissioner Peter McLaughlin, who chairs CTIB. “If we whiff on [Southwest], we’re letting competitor regions with a vision march ahead of us.”

Critics disagree. Light-rail is “really expensive infrastructure to build and keep up that doesn’t work,” said Kim Crockett, vice president of the Center of the American Experiment, a think tank based in Golden Valley. The race for federal transit dollars — also footed by taxpayers — is a wasteful folly, she said.

Even cities like Seattle that are perceived as being transit-friendly have critics. John Niles, who co-founded a Seattle group called Smarter Transit, says the impending ballot initiative in the Emerald City would cost the average person \$1,000 more a year. (The transit agency there, Sound Transit, claims the figure is \$200 a year.)

Niles says Seattle should refine its current system — much of which was built after a 2008 referendum added 2 percent in various sales taxes — before expanding it even more. “Let’s use the existing network to its full potential,” he said. “This may be a bridge too far.”

Meanwhile, other cities and regions continue to look to voters for a thumb’s up on transportation. This fall, more than 20 regions across the United States — from Pulaski County, Ark., to Kalamazoo, Mich., — will hold referendums to raise money for transportation initiatives, according to the Center for Transportation Excellence.

The Minnesota Star Tribune

By Janet Moore

JULY 13, 2016 — 10:33AM

What Record Low Bond Yields Mean for Investors.

The website Quartz reported recently that yields on U.S. 10-year Treasury bonds are lower than they have been since the days of Alexander Hamilton.

But when it comes to bond yields, zero is not the limit. Brexit and uneasiness about the global economy have pushed interest rates on a third of developed-country government debt into negative numbers as investors seek safe havens. That means countries like Germany, Switzerland and Japan are charging investors money for the privilege of holding onto their cash.

Government bonds are many Americans' introduction to investing, and for many of us they represent safety and solidity in a volatile world. In fact, lots of investors have been moving into bonds as the stock market has been in turmoil lately, which is part of the reason yields are falling.

But with returns so low, would we be better off putting money in the mattress?

Not surprisingly, investment managers say no. Bonds are still an important part of your diversification strategy for retirement. This is because they counterbalance movements in the stock market, and their yields are much more stable than those of stocks.

Here are some topics to discuss with your investment manager.

-What types of bonds are best for you?

Again, within the overall category of bonds, most people are most familiar with U.S. Treasuries. They have an interest rate or coupon that is set on the day you buy it and paid out every six months for a term that ranges from 1 to 10 years for Treasury notes, and up to 30 years for Treasury bonds. You get the full principal back when the bond reaches maturity, giving some insulation from market ups and downs. However, there is market risk if you need to sell before the term is up.

The same basic structure is in place for other types of bonds: those issued by foreign countries, by corporations, or by U.S. state and local governments or their agencies (known as municipal bonds). Note that muni bonds can have special federal tax exemption (and possibly state or local tax advantages if you buy them for the city and state where you live).

In all these cases, by buying a bond you are essentially lending money to the entity in question. In general you'll find higher yields where there is also higher risk of default, as when lending to developing countries or distressed U.S. cities, or when buying "junk bonds" issued by higher risk firms, particularly in the energy sector.

-Is it better to own bonds or bond funds?

Bond funds are basically collections of bonds with staggered maturities. Just as with mutual funds full of stocks, you pay a management fee and expense ratio. In fact, the increasingly popular target-date retirement funds tend to include both stocks and bonds.

And, because it's a bouillabaisse of different holdings, there is no guaranteed date that you'll get back your principal.

That said, many investment managers feel that it's difficult to properly diversify through buying individual bonds unless you have a lot of money to park specifically in fixed-income investments.

(What “a lot” means can vary — some say half a million dollars, while others argue that a hundred thousand is plenty.)

And the pressure to diversify is increasing with yields on the standard Treasury bonds so low.

So to recap, for most beginning investors, proper exposure to bonds will come in the form of target-date funds which will give you a selection of U.S. Treasuries, corporate and foreign issues, alongside stocks.

For those with more assets or who are heading closer to retirement — meaning you are shifting more towards fixed-income investments — bond-only funds would be the next place to look.

If you are willing to be an active money manager or work with an investment adviser you trust, you should look beyond Treasuries to buy individual bonds across sectors.

The Chicago Tribune

by Anya Kamenetz

July 12, 2016

(Anya Kamenetz’ most recent book is “The Test: Why Our Schools Are Obsessed with Standardized Testing, but You Don’t Have to Be.” She welcomes your questions at diyubook@gmail.com.)

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Seeking Yield? Consider Insured Munis.

These distressed bonds from troubled places like Puerto Rico or Atlantic City can return as much as 8% after the tax exemptions.

Buying distressed bonds is hardly the stuff of muni investors’ dreams. But with the yield on high-quality intermediate munis down near 1.4%, the opportunity to earn extra income by buying insured bonds from places with weak credit profiles is worth a look.

Consider this: Long-term insured Puerto Rico bonds, the main opportunity for this strategy, yield about 4.5% currently. Given that the interest is exempt from federal, state, and local income taxes, that payment equals a taxable yield of nearly 8% for investors in a top tax bracket.

Insured muni prices have held steady near or above par for years, even as Puerto Rico’s finances deteriorated. In contrast, uninsured benchmark Puerto Rico bonds now trade for 67 cents per dollar of par value, reflecting how much of the face amount investors expect to recoup.

Insured bondholders got paid this month even as the commonwealth defaulted on July 1 on almost a billion dollars in interest and principal payments. At a time when munis are expensive relative to Treasuries and yields are at historic lows, “the insured Puerto Rico story still offers value,” wrote Cumberland Advisors, which manages \$105 million in insured Puerto Rico bonds.

There was a time in the muni market when buying insured bonds was commonplace. The financial

crisis changed that. Bond insurers failed or had to restructure, and even the best firms lost their triple-A ratings. Now the leading muni insurers—MBIA's National Public Finance Guarantee and Assured Guaranty—have credit ratings in the mid-to-upper tiers of investment grade. Investors essentially evaluate the underlying bond based on the insurer's rating. That's why insurance doesn't add value for the great majority of muni bonds, which are rated higher than the insurers.

"You need a broken credit for the market to really assign value to the insurance," says Hugh McGuirk, who oversees municipal-bond investing at T. Rowe Price. That's also why there aren't a ton of insured bonds to choose from. Less than 10% of the muni market is insured now, but that number is increasing, according to National.

IT'S NOT JUST PUERTO RICO insured bonds that investors are buying. Chicago Board of Education insured munis trade at a premium to uninsured, and yields are attractive. National points to bonds issued by Atlantic City, N.J.; Chicago; and North Las Vegas as recent examples of insured bond prices holding steady or rising while uninsured bonds fell. Cumberland says long-term insured munis outside Puerto Rico yield about 2.5%.

Buying insured bonds of weak credits requires extra legwork, says financial advisor Richard Daskin of RSD Advisors. Investors need to assess the underlying bond and the ability of the insurance company to pay if the issuer defaults. He is comfortable with both National and Assured and thinks they merit higher ratings from credit agencies.

Other drawbacks: Daskin experienced a few delays in receiving payments on insured bonds when Puerto Rico defaulted earlier this month, mainly due to paperwork snafus when the default occurred just before a holiday weekend. "It was eye-opening as to how insurance really works," he says. He notes the bonds are not very liquid, so investors should plan to hold them long term.

Mark Taylor, manager of Alpine High Yield Managed Duration Municipal fund (ticker: AAHMX), buys insured munis maturing in under five years. He believes National and Assured can meet their obligations in that period. He owns Puerto Rico bonds maturing in 2020 that yield about 4%.

But this strategy is not for everybody. Greg Steier, head of tax-exempt portfolios at Brown Brothers Harriman, won't buy munis when he's not confident of credit quality, even if there is insurance. "At the end of day, the underlying credit has to satisfy our criteria," he says.

For T. Rowe's McGuirk, insured bonds are "on the table." He adds, "There aren't many other opportunities where you can find yield."

BARRON'S

By AMEY STONE

July 16, 2016

[NASACT Releases Voluntary Guidelines for Stable NAV LPIGs.](#)

These guidelines offer guidance for managing investment pools in a manner that provides state and local government participants with investment options that, when prudently managed, provide safety of principal and liquidity.

New Hampshire Enacts P3 Legislation.

New Hampshire has joined a growing number of jurisdictions in the United States that have enacted legislation enabling public-private partnerships (P3) for transportation infrastructure projects. According to Governor Maggie Hassan, the P3 Law is expected to play an important role in advancing New Hampshire's transportation goals, including, among other projects, bringing commuter rail from Boston to Nashua and Manchester, New Hampshire. The P3 Law, [Senate Bill 549](#), was approved on June 16, 2016 and will take effect on August 15, 2016.

The P3 Law authorizes the Commissioner of the State's Department of Transportation (DOT) to enter into certain types of contracts with private entities for transportation infrastructure projects, and establishes a public-private partnership transportation infrastructure oversight commission to recommend and advise on requests for P3 proposals.

DOT's Authority to Enter into P3 Contracts with Private Entities

P3s allow for certain risks and rewards to be shifted and shared between the private and public sectors. Specifically, according to the P3 Law, "public-private partnerships allow for the sharing of resources to finance, design, build, operate, and maintain transportation infrastructure projects and are especially effective when limited financial resources are available." The responsibilities of the private and public entities involved and associated risks and rewards will generally depend on how the P3 project is structured among various alternatives. Pursuant to the P3 Law, the Commissioner, with the approval of the Governor, Council, and Capital Budget Overview Committee, may now enter into agreements with private entities for design-build-finance-operate-maintain (DBFOM) or design-build-operate-maintain (DBOM) services for transportation infrastructure projects.

- **DBFOM:** Under this P3 structure, the private entity will generally be responsible for the design, building, finance, operation, and maintenance of the project for a specified period of time, while the public entity simply retains title to the asset.
- **DBOM:** Under this P3 structure, the private entity will generally be responsible for the design, building, operation, and maintenance of the project, while the public entity retains title in the asset and secures the funds.

Each P3 project must be approved as part of the State's 10-year transportation improvement program in accordance with Section 240 of the New Hampshire Revised Statutes Annotated.

P3 Transportation Infrastructure Oversight Commission

The P3 Law establishes a public-private partnership transportation infrastructure oversight commission (the Commission) to consider and recommend suitable P3 projects to the Commissioner. The Commission will act as an advisory board during the execution of a P3 project, and support the DOT in the development of a request for proposals and in the preparation of agreements for P3 projects.

Members

The Commission will consist of the following members, each for an initial term of two years: two members residing in different geographic regions of the state to be appointed by the Governor;

two members to be appointed by the President of the Senate; two members to be appointed by the Speaker of the House of Representatives; and one member to be appointed by the State Treasurer who will not be an employee of the State Treasurer's office. The Commissioner will serve as a non-voting member of the Commission. Note that there are additional qualifications and conditions to appointment and reappointment specified under the P3 Law.

Duties

The P3 Law sets forth the various duties of the Commission, which include the following:

- Establish a general framework for P3 contracts and a process for the submission and evaluation of all such projects and forms to enable the bidder to comply with the requirements, including terms and conditions;
- Provide for the submission of unsolicited proposals, and establish qualification criteria and evaluation standards for unsolicited proposals;
- Provide a method and structure for engaging public advisers for strategic planning, proposal evaluations, and project monitoring on a case-by-case basis;
- Perform an analysis to determine whether a project is suitable for P3 whenever DOT notifies the Commission of its intent to pursue a P3 contract;
- Hold a minimum of two publicly noticed hearings per project to establish whether P3 is the appropriate procurement method;
- Make recommendations to the Commissioner, subject to the approval of the Governor, Council, and Capital Budget Overview Committee, concerning the use of P3 for certain projects;
- Upon approval of the Governor and Council and the Capital Budget Overview Committee, support DOT in the development of a request for proposals;
- Provide criteria for qualifications to bid per project, including but not limited to adequate equipment to perform, financial stability, and proven record on projects of this type; and
- Assure that any P3 agreement is advanced in accordance with DOT's design, permitting, and right of way acquisition process and complies with all federal and state design criteria.

Procedures

The P3 Law sets forth certain procedures that must be followed in approving any P3 proposal. The DOT must first notify the Commission of its intent to use a P3 contract for DBFOM or DBOM services by submitting a written request to the Commission for its consideration. The Commission must provide an initial written response within 15 days. No request for proposal may be issued by the DOT without the Commission's written recommendation and concurrence by the Governor and Council of both the procurement method and content of such request for proposal.

Reports

Under the P3 Law, the Commission will be responsible for issuing certain reports, including the following:

- An initial report on the framework for submission and evaluation of P3 projects;
- Annual reports on the work of the Commission, including the number of projects reviewed, recommendations for such projects and the number of requests for proposals being developed; and
- A report for each P3 contract relating to the project's impact on current state employees; policy and regulatory structure for overseeing a privately operated transportation facility; taxation, profit-sharing and resolution of new revenue producing ideas; advertising and marketing; use of new technologies; lease terms and termination clauses; additional responsibilities by both the private

infrastructure operator and the State during the lease period; financial valuation of the state transportation facility; issues of public concern; and anticipated advantages of entering into such P3 contract.

Contributions from Other States

A P3 project in New Hampshire may involve one or more neighboring states. For such a project under the P3 Law, the Commissioner may receive and accept capital contributions and funding from other states and may approve the transfer of support personnel and experts.

New Hampshire's P3 Law is limited to transportation infrastructure projects and does not allow for social infrastructure projects, such as schools, hospitals, and housing, which have become more popular throughout the country. The P3 Law also limits the delivery methods in which P3 projects can be procured.

Attorneys in Ballard Spahr's P3/Infrastructure and Public Finance Groups will continue to monitor and report on new developments in public-private partnerships in New Hampshire and other states. The Groups are recognized leaders in representing government and private sector developers, investors, and lenders in innovative public-private projects.

July 15, 2016

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[Kroll Surveillance Report: Municipal Assurance Corp. \(MAC\)](#)

Executive Summary

Kroll Bond Rating Agency (KBRA) has affirmed the insurance financial strength rating of **AA+** with a **Stable Outlook** for Municipal Assurance Corp. ("MAC"). The rating affirmation incorporates the reduction in claims paying resources from MAC's repayment of \$400 million of surplus notes effective June 30, 2016 to its affiliates.

Key aspects of KBRA's rating assessment are MAC's strong claims-paying resources and the company's diverse insured portfolio which consists of lower risk, predominantly investment grade U.S. municipal exposures. MAC has no exposure to Puerto Rico, which, in light of the

Commonwealth's severely stressed financial position, KBRA views as a credit positive. As a major part of our analysis, KBRA used a Monte Carlo simulation analysis to determine a level of stress losses to be applied to MAC's insured portfolio. KBRA tested MAC's ability to pay this stress level of claims, and other expenses, in a run-off scenario. Under KBRA's Bond Insurer Financial model, MAC satisfied all projected claims due with an adequate balance remaining.

Since the company's capitalization in 2013, new business origination has fallen short of management projections and has not kept pace with the fairly rapid amortization of MAC's legacy exposures. The decline in the insured portfolio combined with MAC's large and stable balance sheet has pushed leverage ratios lower than historical levels.

KBRA also conducted a detailed review of MAC's governance, credit, and risk management protocols and found them to be strong and reflecting best practices. MAC has a proven management team and a well-developed governance framework.

Late in the second quarter of 2016, MAC received permission from its New York regulator to repay the full amount of both series of outstanding surplus notes, ultimately resulting in an asset transfer of \$400 million to MAC affiliates, Assured Guaranty Municipal Corp. ("AGM", AA+/Stable) and Assured Guaranty Corp. ("AGC"). Since its capitalization in 2013, MAC has not paid any dividends. KBRA views the surplus note repayment as equivalent to an extraordinary dividend and we factored this transaction into our rating assessment. While MAC's financial model results from KBRA's stress test remain above the AA+ rating level, the amount of projected excess assets is lower than was calculated for KBRA's last review on August 3, 2015, reflecting the now lower level of claims paying resources following the repayment of the surplus notes.

This rating is based on KBRA's Financial Guaranty Rating Methodology dated December 15, 2015.

[Continue reading.](#)

Think Governments Are a Mess? Markets Don't.

Fear mongers on both sides of the Atlantic would have us believe that governments are failing. They cite racially-charged violence from Dallas to Charleston, South Carolina; voters in Britain choosing to exit the European Union; the flood of migrants from the war in Syria; terrorist-inspired massacres from Brussels to San Bernardino, and the anemic global economy that is dividing generations of workers, families and communities.

Among investors, though, the full faith and credit of governments is at an all-time high, according to data compiled by Bloomberg. If low interest rates on sovereign debts are the ultimate measure of confidence in the governments that issue them, the market remains unshaken. The yield on short- and long-term securities has never been lower, according to Andy Haldane, chief economist and executive director of monetary analysis and statistics at the Bank of England.

As these interest rates are benchmarks for state and local governments, their cost of borrowing has plummeted to record lows as well. U.S. municipalities are financing at 1.54 percent this month, less than the 1.67 percent of 1945 or 4.71 percent of 1933, according to Bloomberg data and the U.S. Government Publishing Office.

The once-widening budget deficit as a percentage of gross domestic product is shrinking in the U.S., to 2.5 percent from 10.1 percent in 2009, and is now a 0.7 percent surplus in Germany.

30-YEAR RETURNS

For bondholders, the total returns (income plus price appreciation) have been a bonanza — surpassing gold, the fear monger's favorite store of value. During the past 30 years, global sovereign debt returned 576 percent, or more than twice the 271 percent return for gold, while U.S. Treasury securities returned 529 percent, according to Bloomberg data. The yield on the 10-year Treasury note, which climbed to a high of 15.8 percent in 1981, is 1.3 percent this month, the lowest since Bloomberg began compiling such data in 1962.

Secular Stagnation

The record-low rates are a symptom of what many economists, led by former Treasury Secretary and former Harvard President Larry Summers, call secular stagnation: Slowing population growth and insufficient technological innovation and capital investment. These economists also see the low rates on U.S. and other sovereign debt as the most propitious opportunity to get economies moving faster because governments can borrow so cheaply to pay for infrastructure improvements, thereby creating demand from higher-paying construction jobs while investing in everyone's future.

The market agrees. So far in the 21st century, the bonds sold to finance roads, bridges, hospitals, sewers and schools have outperformed all state and local government debt as well as the stock market and even gold, according to Bloomberg data. That's because of the combination of after-tax returns and record-low financing costs. The borrowing cost to toll and turnpike authorities, a proxy for U.S. infrastructure financing, is an unprecedented 1.7 percent.

PERFORMANCE SINCE 2004

Since such data became available in 2004, toll and turnpike bonds returned 89 percent, easily beating the 74 percent benchmark for the municipal-securities market. The Standard & Poor's index of U.S. stocks had an 87 percent after-tax return for those in the lowest 28 percent tax bracket — since most investors in tax-exempt securities are in the higher 35 percent tax bracket, though, the advantage to investors in infrastructure bonds has actually been greater.

To be sure, nothing approached gold's 403 percent return during the past 15 years when global high-yield corporate bonds returned 223 percent, investment grade corporate bonds 139 percent, global sovereign bonds 132 percent and Treasuries 102 percent. But gold's price fluctuations are four times that of U.S. Treasuries. On a risk-adjusted return basis, gold has been lagging all categories of the credit market. During the past five years, for example, global high-yield corporate bonds gained 32 percent, followed by U.S. Treasuries at 19 percent, global investment-grade bonds at 18 percent and global sovereign debt at 9 percent. Gold lost 16 percent, according to Bloomberg data.

Gold also loses when taxes are taken into account. U.S. infrastructure debt is mostly tax exempt, which helped it outperform stocks and bonds not only in the long term but also during the past two years and, most recently, during the last 12 months. In that year they returned more than 10 percent compared to the municipal-bond benchmark of 8 percent and the S&P 500's 3.6 percent after-tax return. During the past 10 years, when infrastructure bonds returned 82 percent, gold gained 76 percent on an after-tax basis (assuming most investors are in the 35 percent tax bracket) and gold's volatility, or price fluctuations, was almost six times that of bonds.

So far this year, nothing comes close to matching the returns of infrastructure debt in the municipal market, where North Carolina Turnpike Authority debt has appreciated more than 22 percent, followed by Colorado's E-470 Public Highway Authority's 12 percent and California's Riverside

County Transportation Commission's 11 percent, according to Bloomberg data.

So when Larry Summers calls for "a new approach" starting from "the idea that the basic responsibility of government is to maximize the welfare of citizens, not to pursue some abstract concept of the global good," and to let people "feel that they are shaping the societies in which they live," the market already has ratified this policy by making infrastructure one of the best investments of our time.

BloombergView

By Matthew A. Winkler

(With assistance from Shin Pei)

JULY 13, 2016 5:00 AM EDT

This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP and its owners.

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[As Fed Risk Recedes, Low-Coupon Munis Show Way to Pick Up Yield.](#)

With U.S. bond yields near record lows, municipal-debt investors are finding a way to pick up a little extra return: Buying lower-coupon securities, which provide fatter payouts because they'll be harder hit once interest rates start to rise.

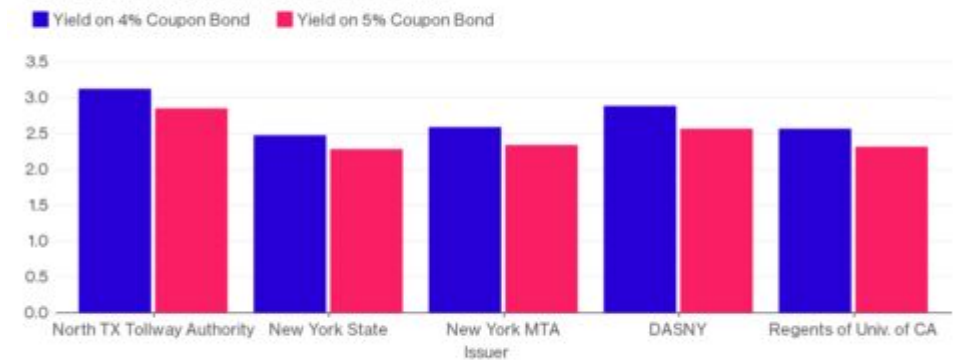
The discrepancy was on display when Massachusetts sold bonds late last month. The state paid a 2.18 percent yield on those maturing in 2038 that pay annual interest of 5 percent. For debt with a 3 percent coupon, the yield was half a percentage point more.

Even such a small pickup can be alluring with negative interest rates overseas, Treasuries paying near record lows and the difference between long and short-term municipal debt narrowing to the least since 2008 — meaning there's less extra income for holding the longest-dated securities. And the risk that the Federal Reserve will soon tighten monetary policy appears to have receded: prices in the futures market suggest a rate increase isn't likely until the second half of 2017.

"Absolute levels of rates are getting so low that for people, particularly high-grade buyers afraid of credit risk, a strategy to outperform is to buy lower coupons," said Peter Block, managing director of credit strategy at Ramirez & Co Inc., a New York-based underwriter.

Yields on 4% Coupon Bonds Exceed Those With 5%

Spread on average almost 26 basis points



Source: Data compiled by Bloomberg
Note: All issues AA rated, maturity above 16 years

Bloomberg

The discrepancy stems in part from a quirk of the \$3.7 trillion municipal market, where most state and local governments give themselves the option to buy bonds back before they're due — usually in a decade — in case they can be refinanced at lower costs.

Because interest rates have largely been on a steady decline since the 1980s, governments have almost always exercised that option. If rates were to rise, which would cause prices of outstanding bonds to fall, those with rock-bottom coupons are more likely not to be called back, leaving investors with the choice between selling at a loss or holding them until maturity.

For bonds with top tier credit ratings, that risk has caused investors to demand about one-quarter percentage point more in yield to hold 10-year bonds with a 4 percent coupon instead those set at 5 percent, Block said. Some mutual funds also have little option but to buy the lower-coupon debt, he said: Many are restricted from paying too much above the bond's face value. As yields have declined, the price of fixed-income securities with higher annual interest payments has soared.

"The question is," he said, "Will four's become the new five's? Will orange become the new black?"

Bloomberg Business

by Molly Smith

July 13, 2016 — 2:00 AM PDT

[MuniLand's Pressing Pension Problems.](#)

Douglas Offerman, Senior Director at Fitch Ratings, talks about the landscape for public pensions with The Bond Buyer. He looks at how state pensions are faring and discusses what impact the new GASB requirements have on disclosure.

[Watch the video.](#)

[Social Impact Investing: A Conversation with Congress and the Financial](#)

Services Industry.

Social impact investing describes the direction of investment funds to opportunities or companies that have desirable environmental, governance or social factors, and is related to social finance, which involves the use financial assets or instruments to fund projects that have a positive social or environmental impact.

Through impact investing, America's capital markets enable programs to improve local outcomes and help communities combat the challenges of long-standing problems such as poverty, pollution, and other social needs.

[Watch the video.](#)

SIFMA hosted a roundtable on Social Impact Investing with industry experts and Members of Congress. The event fueled a discussion on the role of America's capital markets in creating and funding programs designed to improve local communities. Participants discussed Social Finance's Pay for Success Programs, such as the Nurse-Family Partnership in South Carolina and the Connecticut Family Stability Project; and Morgan Stanley's underwriting work for Sustainable Neighborhood Bond, which funds affordable housing in New York, and its Investing with Impact Platform and Sustainable Investing Portfolios, which allow investors of all sizes to invest with impact, making scale in the social finance market possible.

July 14, 2016

By: Chris Killian

U.S. Corporate and Muni Debt Issuance to Hold Steady, CUSIP Requests Show.

NEW YORK, NY, July 14, 2016 – CUSIP Global Services (CGS) today announced the release of its CUSIP Issuance Trends Report for June 2016. The report, which tracks the issuance of new security identifiers as an early indicator of debt and capital markets activity, suggests a steady issuance of new corporate and municipal debt offerings over the next several weeks.

Total CUSIP requests for all U.S. and Canadian corporate securities reached 3,864 in June, up 9% from May monthly totals. Within that broad asset class, there were 797 security identifier requests for new U.S. corporate debt issues, a decline of 9% from May, and 304 CUSIP request for Canadian corporates, a 20% increase over the previous month. On a year-over-year basis, corporate CUSIP request volume for both debt and equity asset classes across the U.S. and Canada was down -0.3% through June 2016 versus June 2015, reflecting weak volumes in January 2016 and comparatively strong issuance volumes in the early part of 2015.

The volume of requests for new municipal CUSIP identifiers saw a fifth consecutive month-to-month increase in June. A total of 1,754 new municipal bond identifier requests were made over the course of the month, a 1% increase from May. On a year-over-year basis, municipal bond identifier requests were up 1.3% in June.

Regionally, municipal bond issuers in Texas demanded the highest volume of new CUSIP identifiers in the first half of 2016, accounting for a total of 1,013 identifier requests during the period. Texas

was followed by New York (774 CUSIP requests) and California (656 CUSIP requests).

“While the month-to-month growth rate of new CUSIP requests in the corporate debt and municipal bond market has slowed from the break-neck pace we were seeing earlier in the year, we’re still seeing indications of very steady new issuance volume for the coming months,” said Gerard Faulkner, Director of Operations for CUSIP Global Services. “As we turn the corner to the second half of the year, we expect the CUSIP indicator to be a telling signal for the market appetite of major debt and equity issuers.”

International debt and equity CUSIP International Numbers (CINS) were mixed in June. Requests for new international debt CINS were down 9%, while requests for new equity CINS were up 48%. On a year-over-year basis international debt CINS were down 30% and international equity CINS were down 61% through June 2016.

“Given all of the uncertainty in the global economy right now, it’s actually quite amazing that CUSIP request volume has stayed so strong,” said Richard Peterson, Senior Director, S&P Global Market Intelligence. “Clearly, issuers across several asset classes still see an attractive environment for raising new capital and that sentiment is continuing to show up in our CUSIP request data.”

To view a copy of the full CUSIP Issuance Trends report, please [click here](#).

Illinois: Should It Issue Bonds or Sell Tax Credits?

That may seem like an odd question until you consider that a tax-credit financing could easily be viewed as ‘AAA.’ That contrasts with Illinois bonds that trade below their ‘BBB’ benchmarks. The difference represents significant value — perhaps more than 100 basis points of savings on long-term offerings.

Here’s a simple example of a proxy financing. Instead of issuing a 1year note that paid \$100 at maturity, Illinois would sell a \$100 tax credit that could be applied any time after one year. It’s an alternative that produces identical net cash flows.

What’s the appeal of the tax-credit alternative? It guarantees that a holder will receive full value as long as he has a matching tax liability. That’s true even if the issuing State is in a financial crisis and can’t pay its bondholders. Imagine where a State’s bonds would trade if it missed a payment. But a tax credit would still be worth 100%. In fact tax credits may be the perfect hedge: as long as taxes are owed, they retain full value.

You might also notice something interesting – using tax credits in this way allows a holder to prepay his taxes at a market discount, which is probably the safest and most efficient way to lend to a municipality.

Still, the ideal solution would be to wrap an ordinary bond around the tax credits, so that a holder has both the convenience of cash pay and the safety of back-up tax credits. That’s the thinking behind a proposed GO structure, Tax Offset Municipal Securities (TOMS). In its simplest form it’s a cash-pay bond, but in the event the issuer can’t pay, bondholders receive equivalent tax credits instead.

In terms of mechanics the Trustee purchases tax credits from the State at the close of the underwriting. This is done under an agreement which acknowledges that the credits are receipts for estimated tax payments. The Trustee would then automatically “put” these tax credits to the State at each payment date for its cash equivalent. If all goes well bondholders would be paid cash as expected and the matching tax credit would expire. But if the State failed to pay, the Trustee would simply distribute the tax credits.

You might ask about the behind-the-scenes machinery. It establishes that a holder’s credit is for estimated taxes already paid. That makes it secure. No one has ever suggested that a State could say to a taxpayer, “We’ve cashed the check for your taxes, but we’re not going to allow the deduction.”

In the end it’s a structure that has the potential to deliver high-grade enhancement without counterparty exposure or credit risk, in effect bond insurance which no traditional insurer can match.

The Bond Buyer

By Paul Fennell

June 30, 2016

Paul Fennell is an independent investment banker specializing in capital market and fixed-income solutions.

[After a Slow Start, PACE Financing Picking Up in Florida.](#)

Property-assessed financing for energy-related improvements to homes and businesses is starting to take off in Florida.

Since Florida’s Supreme Court upheld the state’s Property Assessed Clean Energy (PACE) law against challenges last autumn, applications for the innovative financing have been rising fast, and more local governments are signing up to offer the program in their areas, PACE leaders in Florida say.

“We were probably getting 200 to 300 applications a month, and last month, we got about 1,200,” said Joseph Spector, vice president of operations for Ygrene Energy Fund Florida, the largest PACE lender by far in the state. “Now, we’re active in an area of about 2.7 million people. By the end of the summer, as more cities and counties join, we could be at 5 million people – or about 25 percent of the state.”

Ygrene already has contracted about \$74 million in PACE financing in Florida since starting three years ago in the state. It expects to sign up \$100 million in new financing this year and at least \$200 million more next year, Spector told Southeast Energy News.

Two other PACE players active nationwide also are ramping up in Florida. Renew Financial of Oakland, California entered the state last fall by buying EcoCity Partners of St. Petersburg, and is revising its PACE offerings. And Renovate America of San Diego, California is working to launch a residential program in Florida this October and to expand to businesses financing later, executives confirmed.

“There are no more regulatory or legal challenges” to PACE expansion in the state, said Mike Antheil, market development director in Florida for Renovate America. “It’s now about getting the word out to the people, and it’s trending in the right direction.”

A slow start amid legal challenges

Florida’s Legislature authorized the PACE program in 2010. The law lets property owners borrow funds to make energy improvements such as installing more efficient air conditioning systems, solar panels or hurricane-impact windows. The participants then pay back the money together with property taxes – just like an assessment.

In many cases, savings from increased energy efficiency as well as lower premiums on property insurance are big enough to cover the full cost of PACE repayment. That means the owner has no outlays upfront and no added costs in making the property improvements through PACE. Communities also gain, because contractors get new business and improved energy efficiency helps slow demand for new power plants, PACE advocates say.

Begun in California in 2008 and key to financing solar projects there, the PACE program was slow to take off in Florida – until this year.

That’s largely because of legal challenges, including one by the Florida Bankers Association. The bankers worried that repayment of PACE financing would come before repayment of bank mortgages, when properties were sold or re-financed. Similar cases have surfaced at the federal level and been resolved; the Federal Housing Administration is soon to publish guidance aimed to “unlock” PACE for homes with federally-backed mortgages, industry leaders said.

Last autumn, the Florida Supreme Court dismissed the bankers’ case for lack of standing, and it has upheld PACE in several other challenges, said attorney Erin L. Deady, who wrote an extensive article on PACE for the June 2016 issue of the Florida Bar Journal.

Some cities and counties in Florida delayed authorization for PACE, pending the court rulings.

Brandsmart USA, a chain of consumer electronics and appliance stores based in Hollywood, Florida has become the biggest commercial user of PACE funds in the state so far, with projects totaling \$5 million. It’s mobilized the financing for new air-conditioning, lighting, roofing and other improvements at several stores in what executive vice president Larry Siniwitz calls “a phenomenal program.”

Brandsmart already is “cash-positive” on PACE at its south Miami-Dade store after the first year, saving about 10 percent more on energy bills and maintenance than it costs to back the money – and all without paying a dime upfront, Siniwitz said. It works through a services contractor, ABM, who handles all the property improvements and also guarantees that the savings from the improvements will be enough to repay PACE, he said.

Governments keen on consumer protections

Some local governments in Florida also had concerns beyond the bankers’ and legal challenges.

South Florida’s Broward County, home to Fort Lauderdale, was worried about protections for consumers and for local governments themselves, said Alan J. Cohen, assistant to the county administrator. The county wanted to make sure that consumers knew that PACE may not pay for

itself and could cost them money out of pocket. Plus, the government wanted to find a way to protect cities and the county from lawsuits, if borrowers filed suits against contractors or lenders on PACE projects, Cohen said.

To address those issues, Broward now is putting safeguards in its PACE authorization. First, it is requiring PACE providers agree to cover any costs in the event of a lawsuit related to their projects. Next, it is limiting payments for annual taxes and assessments including PACE to 5 percent of the fair market value of properties – a step taken in other jurisdictions.

In a unique move, Broward also is asking participants to affirm one of three other things when using PACE: Either that the mortgage lender or servicer consents to escrow the PACE assessment; that energy or insurance savings can cover the cost of the PACE assessment; or that the PACE repayment won't exceed 4 percent of their gross income. The county came up with that income standard because of concern over low-income senior citizens being targeted for financial products, Cohen said.

"Consumer protections by far are the most important aspect of what we are moving forward with," Cohen said of PACE.

Unlike some other states, PACE programs in Florida are not run by governments but rather by third-parties such as Ygrene and Renew Financial. Programs typically involve a district that cities and counties can join. The trend now is for local governments to sign up with multiple providers, so that the programs compete.

Not much PACE funding for solar so far

By volume, competition will be largely for residential financing.

At Ygrene, about 99 percent of PACE contracts in Florida so far are for homes and then mainly for hurricane-related protection such as impact windows and new roofs, said Spector. Those upgrades cut insurance premiums. Thicker windows, often with tinted film, also help trim energy costs by keeping out more sun. So far, Solar accounts for only about 6 percent of the PACE funding in Florida, Spector added.

"We recommend property owners secure the building envelope first" with impact windows, roofs and other improvements, said Spector. If people want solar panels later, they can opt for a smaller installation to meet lower energy needs.

Rivals also will compete on terms for funding. Ygrene now offers financing for terms of 5, 10, 15 or 20 years with rates ranging about 6.5 percent to 7.4 percent linked to indexes, Spector said. The average amount financed now runs about \$22,500, he said.

But the biggest difference between programs, industry leaders agree, will be how they treat consumers and contractors.

At Ygrene, Spector said staff is trained to describe PACE to consumers in detail. Some people call in and think because PACE is government authorized, it's free. "You have to explain that it's like going to a bank. You have to qualify first, and you have to pay it off," he said. To protect customers, Ygrene also won't pay contractors until an inspection is complete or the borrower has signed off on the project, added Spector.

The competition is expected to grow as Renew Financial and Renovate America get active in the state. Over time, predicts Spector, "You're looking at a PACE industry that could potentially be at

half a billion dollars in financing per year in Florida.”

Southeastern Energy News

by Doreen Hemlock

July 6, 2016

Doreen Hemlock writes on energy, business, travel and other topics. She's worked on staff at newspapers in the U.S. Virgin Islands, Peru, Venezuela, Puerto Rico and South Florida and contributed to publications worldwide. She holds an MBA from Columbia University and lives in Miami Beach.

Bringing Clarity to Government Finance.

For the average citizen, comprehending government finance is along the lines of comprehending quantum physics.

Fortunately, a new company, ClearGov, has been launched to address the former. We'll leave the latter to institutions of higher learning.

Based in Hopkinton, the startup was founded last year to bring clarity to government finance, hence its name.

And the company has already been making news. Earlier this year, it took first place in AOL Inc.'s TechCrunch PitchOff at the Royale nightclub in Boston. Billed as an event showcasing the “Cream of the Boston Startup Crop,” TechCrunch has been hosting startup competitions in Boston every year since 2013.

ClearGov was one of only 10 finalist startup companies chosen to participate. At the event, its CEO and founder Chris Bullock was given 60 seconds on stage to pitch ClearGov to a packed house of hundreds of attendees and a panel of judges made up of local venture capitalists and TechCrunch editors.

“Everyone has a right to know how their local property tax dollars are being managed,” said Bullock. “ClearGov transforms complex and confusing municipal financial reports into easy-to-understand infographics that benchmark cities’ and towns’ performance against statistical peers. The platform helps local governments better communicate their financial performance to help inform voters and policy makers. Being selected by the panelists as the winner was a great validation for our business and clear indicator that there is demand for tools that help governments drive efficiencies.”

As result of its victory, ClearGov was awarded an exhibitor table in May at TechCrunch Disrupt NY 2016, an event described as “the world’s leading authority in debuting revolutionary startups.”

ClearGov was also recently named by the editors of Government Technology magazine to the GovTech100 comprised of 100 government-focused companies with innovative or disruptive offerings.

Bullock recently discussed his company with Daily News staff writer Bob Tremblay.

QUESTION: Why was the business started?

ANSWER: ClearGov was born from a simple question: “How are my property taxes being spent?” I searched municipal websites and found large, annual reports 200-300 pages long. About halfway into them I would find the financial statements, but they used unfamiliar terminology, had complex transfers between funds and generally lacked any context to the numbers. For example, seeing that a municipality spends \$60 million on education is nothing more than looking at a large number without context. What people want to see is how much of their money goes towards things like education and are the tax dollars being spent efficiently compared to other cities and towns. In other words, I could see a tremendous need for clarifying government data and putting it into perspective. Fulfilling that need facilitates the overall enhancement of government efficiency and public engagement in a most productive manner.

This isn’t my first time taking an opaque industry and making it transparent. I did that in the legal industry as well as co-founder of Sky Analytics, which helped large corporations benchmark attorney rates and matter costs. It has since been sold to Huron Consulting. I was fortunate to combine my analytic background with my co-founder’s solid municipal and executive management operations. ClearGov is my fifth company.

Q: Why did you choose your current locale?

A: I live in Hopkinton and decided to base the business in my hometown.

From April to June, ClearGov was invited to be part of the Innoloft Accelerator at the Constant Contact headquarters in Waltham. We’ve grown from four to eight employees and our development team will soon be expanding, so we have since relocated from Waltham to Hopkinton.

Q: Do you have other businesses or work in other businesses?

A: No.

Q: What does your company do?

A: ClearGov creates financial transparency pages on our website for every town in Massachusetts (and several other states) that are free to the public. We sell expanded, more robust and granular data platforms to the municipalities for an annual fee. Those platforms are linked or embedded in their municipal websites to provide a user-friendly consumer interface for local government transparency. Local municipalities add more recent and detailed financials to the site along with commentary to better tell the story behind figures, to share the metrics that drive budgetary decisions and to access tools to benchmark their municipal budget against the state and their statistical peers.

Q: What makes you different from the competition?

A: Benchmarking: Numbers by themselves are near meaningless to the average citizen. To know that your town spends \$55 million on education is not too helpful, but to know that your town spends 47 percent more than similar towns on education is interesting. Benchmarking provides powerful context to data.

Visual format: Our infographic format is easier to digest for the average citizen; other platforms often have a lot of bells and whistles, but too many options can confuse the average citizen. So we’ve purposely taken a simpler approach to the user interface modeled after infographics.

Market approach: From a more holistic standpoint, our whole market approach is unique. ClearGov.com is a resource for taxpayers. Towns have a presence on ClearGov even without their participation, so towns are drawn to want to manage their presence.

Non-financial metrics: ClearGov intertwines demographic and educational data to better communicate the factors that may be driving costs.

Q: What is the price of your service?

A: ClearGov's annual fee is based on the municipality's annual budget and ranges from \$2,500 a year to \$25,000 a year. ClearGov launched its service to municipalities in December 2015. Framingham, Sudbury, Holliston, Norwell, Norwell, Easton, Athol, Brookline and Upton are just a few of the towns that have already signed up.

Q: Any future plans?

A: ClearGov will be launching in several new states in the coming months.

Q: Any news to report?

A: ClearGov is currently raising a seed round of investment.

Q: Apart from residing in Hopkinton, do you have any other MetroWest connections?

A: I was born and raised in Framingham and graduated from Framingham High School in 1995.

ClearGov's website is www.ClearGov.com.

The Milford Daily News

By Bob Tremblay
Daily News Staff

Posted Jul. 11, 2016 at 12:01 AM

P3s and Tax-Exempt Bonds: Butler Snow

In the past, states and local governments have relied in large part on low-cost tax-exempt financing to meet their infrastructure needs. While there is a growing consensus that our present infrastructure needs are great, many states and local governments are finding it more difficult to continue to borrow to address such needs due to a number of factors, including constitutional and statutory debt limitations, mounting pension liabilities and flat and/or declining revenues. As a result, a number of states and local governments have turned to public-private partnerships ("P3s") to address infrastructure needs. P3s have been successfully used in Western Europe and Canada for many years but have only recently taken root in the United States. A P3 is an arrangement between a governmental entity and a private entity that allows for greater private sector investment and participation in public projects. Sectors where P3s have been used include transportation, energy (including municipal electric and gas generation and distribution facilities, as well as renewable energy projects), telecommunications, water and wastewater, governmental buildings, healthcare, education, housing (affordable, senior, student and military) and hospitality. While Federal tax law requirements often force governmental entities to choose between low-cost tax-exempt financing

and P3s, there are a number of proposals pending that would expand the ability of governmental entities to use both together.

Under Federal tax law, governmental entities may only issue tax-exempt governmental bonds to finance projects where there is little to no private business use. Private business use can arise from any number of arrangements with private entities, including leases and management contracts. Until recently, management contracts generally had to fit within one of the safe harbors set forth in [IRS Rev. Proc. 97-13](#), which essentially only allows for compensation to the private party to be a fixed amount or a fixed amount per unit of service. However, the IRS has recently provided more flexibility with the respect to the terms of such arrangements. [Notice 2014-67](#) added to the list of allowable agreements an agreement where the compensation paid to a private party may include a percentage of gross revenues or expenses of a facility (but not both) so long as the term of the contract is not more than 5 years. In addition, the Notice clarified that a productivity reward generally does not cause the compensation to be based on a share of net profits, which would result in private use, if the eligibility for such award is based on the quality of the services rather than increases in revenues or decreases in expenses and the amount is a stated dollar amount. Even more recently, the IRS released [Private Letter Ruling1 201622003](#), which approved a management contract where a portion of the compensation is an incentive fee that is partly triggered by a variant of net profits. The IRS found that the incentive fee was not structured in such a way that its amount rose in proportion to increases in net profits or fell in proportion to decreases in net profits, and therefore ultimately was not based on a share of net profits. The IRS has indicated that it intends to publish further guidance on management contracts sometime this year, and it is our hope that such guidance will allow for even more flexibility with respect to the terms of such agreements.

In addition to guidance on management contracts, in 2015, the IRS released final [allocation and accounting regulations](#) that will also help to facilitate P3s. These regulations allow for “mixed-use” projects where the governmental portion is financed with tax-exempt bonds and the private portion is financed with equity. In addition, with respect to partnerships, the new regulations look through to the partners so that the amount of private business use is only the private partner’s use of the property.

In addition to tax-exempt governmental bonds, Federal tax law currently allows tax-exempt private activity bonds to be issued to finance a variety of specified projects, including airports, water and sewer infrastructure, solid waste facilities, public education facilities and highway infrastructure. In fact, a number of large P3 projects in the transportation sector have paired credit assistance under the [Transportation Infrastructure Finance and Innovation Act](#) (“TIFIA”) with tax-exempt qualified highway facility private activity bonds. There are also several administration and congressional proposals to enhance existing private activity bonds and to add new categories of private activity bonds. As part of his 2016 proposed budget, President Obama presented the concept of qualified private infrastructure bonds and there is [proposed legislation](#) in Congress that would create Move America Bonds, both of which would help encourage private investment in infrastructure through P3s by allowing for tax-exempt financing of certain types of public facilities where there is private use. Another [legislative proposal](#) would add to the list of tax-exempt private activity bonds certain types of governmental buildings and thus allow for state and local governments to utilize tax-exempt financing for P3 projects involving public libraries, public universities and colleges, courthouses, public hospitals and health care, research and laboratory facilities, government offices, and public safety facilities. Under current law, the amount of many private activity bonds that may be issued annually is limited, but water and wastewater infrastructure P3 projects, which municipalities all over the country have increasingly looked to in order to fulfill the [massive need for capital improvements](#) in that sector, could be bolstered by [proposed legislation](#) that would remove this volume cap limitation for private activity water and wastewater bonds. In a related development,

Congress also recently amended the [Water Infrastructure Finance and Innovation Act](#) ("WIFIA," and modeled after TIFIA) to allow the use of tax-exempt bonds with WIFIA credit assistance.

All in all, leaders in Washington seem to have recognized the growing use of P3s by state and local governments, have taken positive steps to facilitate the combination of P3s and low-cost tax-exempt financing, and are poised to take further action in this area.

by Michael J. Bradshaw

Last Updated: July 6 2016

Butler Snow LLP

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

[BAML Regains Lead; PFM, California Retain Top Spots.](#)

Bank of America Merrill Lynch stormed back in the second quarter to rank first among municipal underwriters for the first half of 2016, increasing its par amount and market share from a year earlier.

[League Tables](#)

Public Financial Management Inc. remained atop the financial advisor league table and the state of California was the largest municipal issuer.

BAML closed the quarter with a par amount of \$20.76 billion in 161 issues, or 17.5% market share for the second quarter. For the first half, the firm finished at \$33.98 billion in 283 deals, for a 15.8% market share, up from \$27.85 billion in 263 deals or 13% market share in the first half of 2015, according to data from Thomson Reuters.

Overall, the top 10 firms combined for a total par amount of \$214.51 billion in 6,417 transactions compared to \$215.01 billion in 6,839 transactions in the first half of last year.

"It's a spectacular opportunity right now and we are working hard at helping our clients to come to market and take advantage of the low rates," Jonathan Nordstrom, head of municipal sales and trading at Raymond James, which climbed two places to eighth in the first half ranking. "There is excellent interest in muni bonds and we are even seeing the international customer coming in, it's an incredible market right now but rates could go lower."

Citi, which finished in first place after the first quarter, dropped back down to second place with a total of \$27.29 billion in 290 deals or 12.7% market share in the first half. That compares with to \$25.34 billion in 279 deals or 11.8% market share in the same period last year, when Citi was also in second place.

For the second quarter, Citi had a par amount of \$14.05 billion or 11.8% market share. Citi was the lead bookrunner on some of the largest deals so far this year, including the \$2.9 billion general obligation sale in March from California and the \$2.4 billion LaGuardia airport deal, which was the biggest airport and alternative minimum tax deal to ever hit the market.

JPMorgan finished both the quarter and first half in third place. For the quarter, the bank had \$13.56 billion in 133 transactions or 11.4% market share. JPMorgan finished the half with \$22.03 billion in 221 deals or 10.3% market share, down from \$24.67 billion in 245 deals or 11.5% market share in the first half of last year, when it also ranked third.

Morgan Stanley finished the first half in fourth place, with \$14.91 billion or 7% market share, down from \$18.02 billion or 8.4% market share a year earlier. They also finished in fourth place for the second quarter, winding up with \$7.92 billion or 6.7% market share for the past three months.

Rounding out the top five is Wells Fargo, which moved up one spot from last year and finished the first half with \$14.75 billion or 6.9% of the market, which compares to \$11.54 billion or 5.4% in the first half of 2015, which was good for sixth place.

RBC Capital Markets was sixth with \$10.94 billion, followed by Stifel with \$9.14 billion but had the most number of deals with 485.

Raymond James was the biggest mover, jumping up two spaces to number eight with \$8.98 billion.

"We are pleased with how the year has gone, working hard to try and increase market share and influence and impact on our customers," said Nordstrom. "Our competitive underwriting desk has done a great job of pulling business and that is connected with our sales force, who continues to get better. We are seeing more engagement with customers and that has helped propel our performance."

Piper Jaffray was ninth with \$8.13 billion and Barclays finishes the top 10 with \$6.97 billion.

Financial Advisors

Public Financial Management was once again atop the first half league tables for financial advisors, as they increased its par amount and market share from last year. PFM finished the half with \$39.50 billion or 21.9% market share, which was up from the \$35.65 billion and 19.8% market share from the first half of 2015.

"PFM was pleased to increase our market share during the first half of the year compared to the first half of 2015, even as bond volume declined," said John Bonow, chief executive officer and managing director for the PFM Group. "We believe that the increase is due to two factors: our consistent ability to help clients identify refinancing opportunities in the prevailing low rate environment and a good number of clients focused on creative and sustainable ways to finance much needed projects and infrastructure."

Bonow said low borrowing rates seem to have real traction as the world digests the U.K. exit path from the European Union.

"Domestic economic indicators continue to be mixed, but worldwide financial and economic uncertainty will likely depress the appetite for the Federal Reserve to take action on rate increases and that may encourage many state and local governments to make longer-term commitments to infrastructure and social program investments," he said.

Bonow said he expects PFM to continue to bring effective solutions to its current and future clients who understand the value PFM provides through our practical and sustainable financial solutions to their challenges.

Hilltop Securities, which was in third place at the end of the first quarter, moved up into second

place to finish the first half, the same position they were in at the end of the first half last year. Hilltop's par amount was \$18.49 billion. Public Resources Advisory Group finished the half with \$17.36 billion for third place, after finishing the first quarter in second place.

The two biggest movers in the ranking were the firms rounding out the top five: Acacia Financial Group Inc. and Kaufman Hall and Associates Inc.

Acacia moved up to fourth, after finishing the first half of 2015 in sixth place. The New Jersey based company finished the first half with \$8.30 billion, up from the \$4.21 billion in the first half of 2015.

Kaufman Hall and Associates moved into the fifth spot after posting \$4.04 billion in the first half of this year.

Negotiated Underwriting

BAML claimed the top spot for underwriting negotiated deals, with a par amount of \$22.39 billion for the first half this year, compared with \$17.78 billion during the same period last year when it finished third. Citi remained in second, the same spot as in the first half last year, with \$19.91 billion. JPMorgan, which was in first at this point last year, fell to third with \$15.50 billion. Morgan Stanley was fourth with \$10.83 billion and RBC fifth with \$10.68 billion.

Wells Fargo ranked sixth with \$10.61 billion, followed by Stifel with \$8.74 billion, Piper with \$7.00 billion, Raymond James with \$6.84 billion and Barclays with \$6.31 billion.

Competitive Underwriting

BAML finished the first quarter atop the ranking for competitive-only deals with \$11.59 billion, followed by Citi with \$7.39 billion. JP Morgan was third with \$6.52 billion. Robert W Baird & Co., was fourth with \$4.28 billion, moving up from sixth at this point last year and Wells Fargo was fifth with \$4.14 billion, as it made the biggest year-over-year leap, moving up from sixth place a year ago.

Morgan Stanley was sixth with \$4.08 billion, followed by Raymond James with \$2.14 billion, Hutchinson Shockey Erley & Co. with \$1.24 billion, Piper with \$1.13 billion and FTN Financial Capital Markets with \$885 million.

Top Issuers

The state of California is the No. 1 issuer for the first half of the year, retaining the top spot it held after the first quarter of the year. In total so far this year, the Golden State has issued \$4.52 billion of bonds.

"Our general obligation bonds are what we issued the most of so far this first half," said Tim Schaefer, deputy treasurer, public finance, for California Treasurer John Chiang.

The Golden State came with a whopping \$2.9 billion GO sale in March, which was more than half refunding. The final amount was split into \$1.1 of new money and \$1.8 of refunding, which gave the state \$294 million of present value savings. In April, they came back with \$1.5 billion, which was mostly refunding and they netted another \$195 million of PV savings.

Schaefer said that refundings are driving the volume.

"With interest rates as low as they are, we are being very aggressive in refunding everything we can get our hands on as long as it makes economic sense," he said. "The market has been very kind to us

in the last 18 months, offering us very attractive yields and trading at much tighter spreads from the MMD scale that our ratings would imply.”

Schaefer also said that the state is in much better financial position than it has been in a long time and that the market appears to be telling us they have greater confidence in the state’s ability to manage it out of tough situations.

“As long as the supply and demand stays this way, we will take advantage. We are high grade, but not yet triple-A, so that hand full of basis points of extra yield makes a difference.”

Although an issuer from the west coast held the top spot, the east coast was well represented with four of the top five spots, including three issuers from New York City.

The New York Transportation Development Corp. was second with \$3.25 billion, most of which came during the mega LaGuardia deal.

The NYC Transitional Finance Authority was third with \$2.65 billion, followed closely by the Commonwealth of Massachusetts with \$2.64 billion. The NYC Metropolitan Transportation Authority rounds out of the top five with \$2.62 billion.

The Bond Buyer

By Aaron Weitzman

July 6, 2016

The Rise Of Social Impact Bonds.

The social impact bond or pay for success program (“PFS program”) is an alternative private financing model used to test social impact programs before governments step up to finance such programs. In these programs the government contracts with a private sector intermediary to obtain social services. The intermediary obtains funds for the services by raising capital from private commercial and/or philanthropic groups. The intermediary uses these funds to pay a service provider to deliver the social services. Over a set period of time, performance of the social services is measured, usually by a third party consultant, based upon up-front established criteria. After the review period, the government pays the investors only if the performance targets are met.

As of the end of 2015, there were eight (8) established PFS contracts in the United States and more in the pipeline. The Corporation for National and Community Service through its Social Innovation Fund launched a PFS program and selected eight (8) initial grantees through which 43 programs are receiving technical assistance. Banks such as Goldman Sachs, Northern Trust, Bank of America, Merrill Lynch and Santander Bank have invested capital in PFS programs. In addition, federal legislation, known as the Social Impact Partnership Act, has been introduced to help establish PFS programs, and six (6) states (Colorado, Idaho, Massachusetts, Oklahoma, Texas and Utah) have passed PFS enabling legislation. Other states are considering legislation or participating without legislation.

Despite the trend toward expanding PFS programs, there are some criticisms. PFS programs can be more expensive than direct government funding due to costs of legal services, program administration and loan management. There are also questions about how outcomes are measured,

since the “success” of most programs is measured in a relatively short time frame considering the deep-rooted social problems that are being addressed. In addition, data suggest that investors want to minimize risk and back programs where there is more evidence of possible success. Detractors of PFS programs argue that governments should finance these programs themselves based upon the probability of success. Despite the questions and criticisms, it appears from the significant increase in PFS programs that this type of investment tool is here to stay, at least in the short-term.

by Francina J. Critzman

Last Updated: July 8 2016

Miles & Stockbridge

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

How the Muni Market Sails Past Disaster.

How do they do it?

Municipal bonds maintained a trajectory to the record highs reached last week as a series of bankruptcies, budget debacles and defaults failed to damage investor confidence in the industry as a whole.

Municipal analysts and experts say decades of improvements – from enhanced disclosure and heightened enforcement to increased transparency and growth of technological advancements – have helped the broader tax-exempt market build immunity to isolated debacles in distressed municipalities.

Improved credit surveillance and information flow, advancements in online trading platforms, better market technicals, and the economy have helped investors shrug off a range of fiscal debacles from today’s credit crises in Puerto Rico and Illinois, to the historic \$18 billion Detroit bankruptcy in 2013 and the \$2 billion Orange County, Calif., default back in 1994.

Robert Doty, president of Annapolis, Md.-based municipal securities consulting firm AGFS attributes munis’ staying power to better disclosure practices and market discipline enforced by the Securities & Exchange Commission.

“The market continues to function even though we have a major issuer in the market – Puerto Rico – defaulting, and Illinois is teetering,” he said.

Disclosure and Market Stability

Some analysts say the stability of the market is tied to economic progress and the general credit worthiness and demand for tax efficiency in the \$3.7 trillion municipal market.

“As long as the tax base and the population remain near current levels the market will continue to let Illinois kick the can down the road,” Michael Pietronico, chief executive officer at Miller Tabak Asset Management, said in an interview last week.

Overall, the municipal bond market has awarded lower borrowing costs to issuers with strengthening finances, and that has helped the market retain its positive nature in the midst of recent credit and fiscal crises, Pietronico said.

"Issuers believe market access is a right when in fact it is a privilege," he added.

"Detroit is a prime example of that phenomenon as they leaned on the rest of the state of Michigan to gain market access when in many minds they were bankrupt and unable to fund their own liabilities."

"Puerto Rico understands that 'penalty box' quite well, while states such as Illinois continue to pay a yield premium in a market starved for yield," Pietronico added.

Doty, who has over 45 years of experience in the municipal industry, said disclosure and transparency enforced by the SEC have continued to improve, protecting today's market in the face of credit debacles.

"We have a lot of guidance and the market has improved considerably," he said, referring not only to SEC disclosure and enforcement practices, but also the guidance and market support from the National Association of Bond Lawyers and National Federation of Municipal Analysts.

Problematic credits, such as the state of Illinois, Chicago, and New Jersey are viewed as "one-offs" that are isolated from the general market, according to Jeffrey Lipton, managing director and head of fixed income research at Oppenheimer & Co.

"These are high profile names that take up significant headline real estate, and for the most part, should not deliver very many surprises given the information flow and heavy analytical coverage," Lipton said. "The muni market is a \$3.6 trillion entity with an extremely high percentage of bonds meeting timely payment of principal and interest. The asset class also experiences much higher recovery rates as compared to corporate bonds."

David Litvack, managing director and head of tax-exempt research at U.S. Trust, Bank of America Private Wealth Management said the municipal market is "benefitting from a very favorable technical environment, in which demand for tax exempt income is overwhelming available supply."

New deals are oversubscribed, and low nominal rates have caused credit spreads to tighten over the last few years as investors search for yield, he said.

"We believe Puerto Rico's credit problems have not resulted in contagion to the broader muni market, because the commonwealth is seen as an outlier," Litvack added.

Puerto Rico's fiscal and economic declines with associated bond defaults are not expected to have a systemic impact upon the broader municipal market, because its fiscal story has been widely publicized in recent years, according to Lipton.

"There has been a substantive shift in trading participants and commonwealth bond ownership to more sophisticated investors such as hedge funds and distressed buyers," Lipton said in an interview last week. "We continue to believe that any temporary market sell-off that may be triggered by a Puerto Rico event could give rise to buying opportunities," he said.

Historical Comparison

Decades of industry advancements – some as basic as information flow – have helped the market

evolve and strengthen.

"In the 1970's the market still had physical certificates and coupons to clip," John Donaldson, director of fixed income at The Haverford Trust Co. said last week. "Today, municipal bonds trade and settle like any other issue."

Transparency has evolved and contributed to better market participation.

"We can see the details on any public issue from our Bloomberg terminal; we can access updated financial reports with a click," Donaldson said. "Back then it could easily take a week to get information necessary to make a decision on a credit you did not own."

"Price information in the form of MSRB trading data is also transparent. Secondary market pricing in the 1970's was anything but transparent," he added.

The advent of official statements on general obligation deals helped to define the practice of increased disclosure to and education of investors over the last three decades, Doty of AGFS said.

The market in recent years has fared significantly better than it did back in the mid-1970s when New York City faced default on its GO debt in 1975 due to the ill effects of a stagnant economy, according to Doty. It narrowly avoided default after the Teacher's Union agreed to invest \$150 million to buy Municipal Assistance Corporation bonds, followed by a \$1.3 billion in federal loans to the city for three years.

"The market was extremely disruptive when New York City had its problems, but it's a contrast, and the difference in my view is that investors can distinguish between credits and back then they couldn't," Doty said. "Official statements weren't being used very much for GOs, and New York City didn't use one until 1975."

Now, traders are able to value so-called troubled bonds based on the specific risk and arrive at yields that satisfy the investor community - something that couldn't be done in the 1970s because the pricing and credit information wasn't easily and readily accessible, Doty of AGFS said.

Despite the distressed outliers, investors can rely on municipal bonds for capital preservation, portfolio liquidity, tax-exemption, as well as strong credit quality, Lipton said.

"The muni market of 2016 has, in some ways, become an extension of 2015, but overall performance is poised higher this year," he added. "Muni bond buyers have been nicely rewarded just by staying invested and clipping their coupons," he added. "Year-to-date, Barclays shows munis have returned 4.49%, versus 5.52% for Treasuries."

Lipton said a so-called "perfect storm" may create an attractive municipal bond market that may lead to even lower yields - even with the ongoing debacles.

"A more accommodative Fed, the Brexit vote - with all of the associated uncertainty - variability in economic data, strong market technicals, and an enduring competitive edge are all converging," Lipton said. "This dynamic is expected to extend the market's 38 consecutive-week run of positive mutual fund flows, despite noted retail and institutional resistance to currently lofty prices."

The Bond Buyer

By Christine Albano

July 1, 2016

Clayton Co, GA Facing Possible Litigation Over Blocking Out-of-State Issuer.

Clayton County officials blocked without explanation Tuesday night a plan to issue tax-exempt bonds to renovate three apartment complexes that are home to 2,500 residents.

The plan Tuesday would have enabled a nonprofit to buy and renovate the apartment complexes using tax-exempt bonds issued by Wisconsin-based Public Finance Authority. The project now will have to be done using taxable bonds. About 50 residents from the three apartment complex showed up for the commission meeting.

Commission Chairman Jeff Turner, who supported the deal, asked commissioner Michael Edmondson, who brought the measure before the board, to explain his reasoning for blocking the deal. Edmondson replied "I don't think it's in the best interest of the county." When asked after the vote to elaborate, Edmondson declined to give details.

The Public Finance Authority deal would not have created any financial risk to the county, said Richard deGorter, executive director of Linked Economic Development & Affordable Housing Foundation or LEDAHF. LEDAHF is a 22-year-old nonprofit in the Washington, D.C. area that has been buying and rehabbing properties along the east coast to preserve affordable housing. The Clayton project is LEDAHF's first in Georgia.

The loss of tax exempt status for the \$50.7 million bond issue will cost LEDAHF about \$500,000 a year more or about \$17 million over the life of the 35-year bonds, deGorter said.

DeGorter told The Atlanta Journal-Constitution he will look at taking the case to federal court with the help of national nonprofits that pursue such litigation.

"In 40 years as a developer, I've never encountered anything as irrational and, I believe, illegal as this vote," deGorter said. "The lack of accountability and transparency on the board is unprecedented in my experience and extreme. We're exploring bringing the federal government (into to this case) because it's a violation of the Fair Housing Act because they're obstructing the provision of affordable housing."

Despite the county's decision, deGorter said: "We're still going to buy the properties but this action bars us from getting tax-exempt bond financing. "

LEDAHf is under contract to buy Laurel Pointe and Bradford Ridge apartments, both of which are in the northwestern part of Clayton, Commissioner Gail Hambrick's district. Hambrick voted to block the plan. The nonprofit also plans to buy Ashford Ridge, a 250-unit complex in the center of Clayton, commissioner Michael Edmondson's district. Edmondson also voted to reject the financing by Public Finance Authority. Commissioner Sonna Singleton Gregory cast the third vote, effectively killing the tax-exempt bond deal. Commissioner Shana Rooks voted in favor of the deal.

The three apartment complexes are owned by JAMCO Properties, which owns 20 apartment properties in metro Atlanta, most of which are clustered in Clayton. A review of online comments about JAMCO showed complaints about the properties ranging from aging pipes to poor treatment by staff to flooding.

"I'm very disappointed. It's a decision that has great impact on a whole lot of people. This (plan would) renovate apartments, beautify the area and increase the tax base. I don't know why he's doing this," Turner told the Atlanta Journal-Constitution regarding Edmondson's action. "He owes the citizens of Clayton County an explanation."

The Atlanta Journal-Constitution

By Tammy Joyner

Posted: 3:05 p.m. Wednesday, July 6, 2016

Bonus Yields Found in Muni-Bond Niche Tax-Free to Most Americans.

As bond yields dwindle worldwide, investors are turning to a \$150 billion niche of the municipal market that offers higher payouts because of the risk they'll be subject to a tax that few Americans actually pay.

The securities, which finance airports, housing agencies and non-profits, provide yields that are more than half a percentage point above typical state and local debt. That's because the interest is covered by the Alternative Minimum Tax, a federal provision that applies to about 4 million high-income earners a year. For everyone else, it's tax free.

"The demand for AMT bonds has grown because everyone is in search of yield in this yield-starved market," said Tommy Chan, a senior credit analyst in New York for Ziegler Capital Management, which oversees about \$11 billion and has been buying some of the debt for clients who aren't subject to the tax. "The yields have compressed over the past year, but we still think there's value there."

Taxable debt has been among the best performing in the municipal market, in part because of money pouring in from overseas while officials hold interest rates below zero in Germany and Japan to spur economic growth. The bonds have returned 11.2 percent since the beginning of the year, more than double the 4.7 percent on traditional tax-exempt securities, according to Bank of America Merrill Lynch's indexes.

When New York's LaGuardia Airport sold \$2.4 billion of the AMT debt in May, 30-year securities with a 5 percent coupon yielded 3.27 percent, about 2 percentage points more than top-rated debt, according to data compiled by Bloomberg. The price has since climbed, pushing the yield down to about 2.8 percent, narrowing the premium over the benchmark to 1.6 percentage points.

The prospect of paying the AMT — which ensures that deductions aren't used to erase most or all of one's bill to the Internal Revenue Service — has usually made the bonds less appealing to municipal debt investors, who typically look for tax-free investments with little risk. The AMT, however, has become less likely: It applied to just under 4 million tax returns — or 2.7 percent of the total — in 2013, according to data compiled by the Tax Policy Center. That's down from as much as 4.3 million in 2011.

The more one earns, the less of a concern the AMT becomes, according to Chan. For those whose income exceeds \$1 million, the likelihood drops to just 18 percent, compared with 63 percent in the \$200,000-\$500,000 bracket.

Nor is the tax risk an issue for investors outside the U.S., who have been stepping up purchases of

municipal bonds that offer bigger yields than can be found at home.

Investors are still looking to take advantage of owning more AMT bonds in their portfolios, said Rob Amodeo, head of municipals in New York for Western Asset Management, which oversees about \$440 billion.

"If you have a standalone portfolio and understand your clients' tax status that they're not subject to AMT and don't anticipate being subject to it in the future, then absolutely, it's an opportunity," he said. "It's a strategy we've been using over the last few years."

The increased demand from buyers has been a boon for public-works projects by driving down the cost of financing. AMT bond issuance totaled about \$16 billion in 2015, and \$12 billion has been sold already this year, according to data compiled by Bloomberg. The Massachusetts Port Authority is planning to offer \$172 million next week for Boston's Logan International Airport.

"The country has embarked on large infrastructure projects, which has been reflected in a pickup in AMT bond issuance," Amodeo said.

Bloomberg Business

by Molly Smith

July 8, 2016 — 2:00 AM PDT Updated on July 8, 2016 — 9:19 AM PDT

[Even Puerto Rico Rallies in Muni Market Wells Says Is Too Frothy.](#)

The world's bubble-like bond rally has found its way to the U.S. municipal market.

The price of junk-rated Ohio tobacco debt that may never be paid in full has climbed 14 percent since the start of the year. New York City's Albert Einstein College of Medicine sold \$175 million of unrated securities in January at par for a yield of 5.5 percent. Now, they're worth 122 cents on the dollar and yield 2.8 percent, according to data compiled by Bloomberg. Even those issued by Puerto Rico, which has been defaulting on a growing share of its debt, have returned 8.4 percent.

"What has changed in the last six months that makes the credit worth more?" said Lyle Fitterer, who oversees \$40 billion as head of tax-exempt debt for Wells Capital Management and has been buying higher-rated bonds instead. "I'll tell you what's changed: the money flowing into high-yield funds."

That corner of the \$3.7 trillion municipal market, home to bonds backed by hospitals, speculative real estate developments and settlement payments from tobacco companies, has turned into a mad scramble. With interest rates hitting record lows around the world, investors are grasping for anything that promises bigger returns, driving a run up that will leave them at risk if the pendulum swings the other way.

As money poured into municipal mutual funds for the last 39 straight weeks, \$8.3 billion — or more than one-third of the total — went to those focused on high-yield securities, according to Lipper US Fund Flows.

As a result, the extra payouts investors demand to compensate for risk has shrunk. Excluding Puerto Rico bonds, the difference in the yields of investment-grade and high-yield munis has narrowed to

about 2.7 percentage points, 0.65 percentage point less than the average since 1995, according to Barclays Plc.

Securities that can be bought in blocks of \$1 million or more, such as new issues and tobacco debt, are in high demand. When a private consortium borrowed \$2.4 billion to finance the redevelopment of LaGuardia Airport's Central Terminal Building, investors placed 10 times as many orders as bonds available, according to LaGuardia Gateway Partners, the manager of the project. The securities were rated Baa3 by Moody's Investors Service, one step above junk.

John Miller, who oversees Nuveen Asset Management's \$14 billion high-yield muni fund, said a more accurate gauge of the risk of high-yield securities is to compare them to AAA rated tax-exempt bonds. By that measure, high yield municipals — excluding Puerto Rico — are trading at 2.4 percentage points more than top-rated bonds, or 0.1 percentage point less than the historical average.

"That's attractive for having already eliminated the most volatile part of the market and the market that has the highest default risk," said Miller, co-head of fixed income for Nuveen in Chicago. "Outside of Puerto Rico, we're not seeing real stress."

Tobacco bonds, which are backed by payments from cigarette companies under a 1998 settlement with 46 U.S. states, have benefited as smokers plowed savings from lower gasoline prices into cigarettes.

Moody's projects 80 percent of the securities may default, based on historical declines of 3 percent to 4 percent in U.S. smoking. Cigarette shipments, which determine the payouts that states used to fund the debt, increased 1.9 percent last year, the most ever, according to the National Association of Attorneys General.

"That's a big swing," said Miller.

Last year's bump is an anomaly, said Ken Shea, a senior analyst with Bloomberg Intelligence in Skillman, New Jersey. In the first three months of the year, shipments declined 5.5 percent from the previous quarter, according to Management Science Associates, a data and analytics firm.

The muni market is pricing high-yield bonds with the belief that interest rates will stay low for a long period and the economy will grow at a moderate rate, said Wells's Fitterer.

He said that forecast may not be far off the mark. But with prices already having rallied so much, Fitterer is buying the least risky securities and letting his fund's high-yield holdings decline as bonds mature. For example, a AA- rated Metropolitan Transportation Authority bond maturing in 2044 is trading at an average yield of 2.3 percent, just 0.5 percentage point less than the unrated Albert Einstein bonds. Einstein forecasts a \$62 million loss in 2016, and 60 percent of its revenue comes from grants, contracts and gifts.

"We all know that at some point the markets will turn," he said. "You have to look at the portfolio and say, 'Gee, am I getting paid enough to take the incremental credit risk?'"

The indicated yield on Wells's high-yield fund is 2.79 percent, compared to 6.35 percent for the Oppenheimer Rochester High Yield Municipal Fund, the highest of 40 such funds tracked by Bloomberg.

"We've always told people if we don't see value in high yield we're going to go where we see the best relative value," Fitterer said. "If people don't want to buy my fund, I'm fine with that."

Bloomberg Business

by Martin Z Braun

July 7, 2016 — 2:00 AM PDT

[Bloomberg Brief Weekly Video - 07/07](#)

Taylor Riggs, a contributor to Bloomberg Briefs, talks with reporter Joe Mysak about this week's municipal market news.

[Watch the video.](#)

July 7, 2016

Utilities Log Fat Gains Amid Market Turmoil.

The price of security in financial markets keeps rising, and many investors are still paying up.

As investors have flooded into government bonds in recent weeks, pushing yields on the 10-year Treasury note to record intraday lows, they also bought shares of utility companies. Known as bond proxies because they pay relatively high dividends and are considered less risky than other S&P 500 sectors, shares of U.S. power and water providers have climbed 21% in 2016, gaining along with other haven assets like gold.

The run-up has made utility shares more expensive than usual compared with their last 12 months of earnings. The price-to-earnings ratio for utility stocks was roughly 21 on Thursday, compared with a 10-year average of 15 and higher than the S&P 500's P/E ratio of 18.

It is a reflection of investors' continued jitters about slowing global growth and the political and economic fallout from the U.K.'s vote to leave the European Union. Utilities were the only S&P 500 sector to rise in the meltdown immediately following the result.

Because utility companies provide critical services to U.S.-based customers, their stocks are relatively isolated from the turmoil overseas, while the recent fall in already-low government bond yields has also made such dividend-paying stocks more attractive in comparison, several analysts and investors said.

A wave of fear in the aftermath of the Brexit vote and an extended period of economic anxiety in 2016 have been more than enough to overwhelm concerns that the stocks are overpriced and suffering from diminishing returns.

"All of those components together lead to a favorable environment for utilities," said Erik Davidson, chief investment officer at Wells Fargo Private Bank. "And yes, valuations are stretched, but if you look at global bonds, valuations are even more stretched."

Last year, the sector lagged behind the broader market, falling 8.4% in 2015 as the S&P 500 lost 0.7%.

Utility stocks in the S&P 500 offer a dividend yield of 3.4% according to FactSet, behind only telecommunication stocks. That compares with a yield of 1.492% on the 10-year Treasury note on Thursday.

Government bond yields hit record lows in countries including Germany and Japan after the U.K. vote. Investors' expectations for a rate increase from the Federal Reserve have fallen precipitously, increasing the appeal of dividend-paying stocks.

Some of the better-performing utility companies this year include American Water Works Co., Inc., which has gained 40%, NiSource Inc., a natural gas and electrical provider that is up 36%, and CenterPoint Energy, which has risen 31%.

There is relative certainty about utilities' performance and ability to pay dividends, said Mike Barclay, senior equity portfolio manager at Columbia Threadneedle Investments. "When people are looking for yield in a low-rate environment, that's very attractive. You can sleep a bit at night."

Other haven assets have also gained considerably this year. Gold is up 25%. Yields on municipal bonds hit historic lows in June. Yields fall as prices rise.

Some investors said that even as low bond yields demonstrate the appeal of relatively safe, income-producing investments, utility stocks have grown very expensive, underscoring the risk of sinking money into stocks that have already shown big gains.

Other assets favored because of their dividends have taken a hit recently. These includes bank stocks, which have fallen amid concerns that low rates will pressure their profits, and energy-focused master limited partnerships, which suffered when oil prices fell.

"Don't chase income and especially don't chase it after everyone else has started chasing it," said Allan Roth, a financial adviser at Wealth Logic in Colorado Springs. "The fact that utilities have gone up so much means it's an especially poor time to do it."

While expectations for rising rates have dwindled, utility stocks are expected to suffer if bond yields rise, making debt more competitive with the shares because investors have less need for utilities' income. Economic growth could also cause investors to rotate to faster-growing sectors, leaving utilities behind.

"If we see growth prevail, we suspect they'll be less rewarded than other spaces," said Eric Wiegand, senior portfolio manager at U.S. Bank's Private Client Reserve.

Still, some investors and analysts said it makes sense to stick with the stocks because there are few alternatives.

"People come in, they hit the switch and they expect the lights to go on," said Jack Caffrey, equity portfolio manager at J.P. Morgan Private Bank. He has trimmed his utility exposure, but the run-up means he's still overweight the sector. "You're not worrying about how a plebiscite in a country 12 hours away is going to do to demand for electricity."

THE WALL STREET JOURNAL

By AARON KURILOFF

July 1, 2016 2:53 p.m. ET

National League of Cities Launches First-Ever Equitable Economic Development Fellowship.

PORTLAND, OREGON — The National League of Cities (NLC), PolicyLink and the Urban Land Institute (ULI) are convening today in Portland, Oregon to launch the first-ever Equitable Economic Development Fellowship. Six cities were chosen to participate in the inaugural year of the fellowship: Boston, Charlotte, Houston, Memphis, Milwaukee, and Minneapolis.

The Equitable Economic Development Fellowship is a two-year, \$1 million effort to help equity, transparency, sustainability and community engagement become driving forces in local economic development efforts. During the fellowship, which is generously funded by the Surdna Foundation and the Open Society Foundations, economic development leaders will convene for leadership development, technical assistance, and peer learning. Another class of six cities will be invited to participate in the second year of the program in 2017.

“Historically, many communities have not seen the benefits of local government economic development policies and programs. It isn’t difficult to find examples in cities and states around the country where local governments have particularly shortchanged people of color, immigrants and low-income neighborhoods,” said Jess Zimbabwe, director of the Daniel Rose Center for Public Leadership in Land Use at NLC and ULI. “Some cities are looking for a new path forward, developing creative strategies to jumpstart their economies and to more inclusively invest public dollars.”

While in Portland, each city team will identify a particular equity challenge in economic development to focus on during the course of the fellowship. The cities will receive support and technical assistance from NLC, PolicyLink and ULI, as well as their peer cities, to address the specific diversity and inclusion challenge. While in Portland, the city fellowship teams will also hear from Mayor Charlie Hales and leaders from the Portland Development Commission about the city’s strategies for moving the needle on equity and inclusion.

“It’s important for cities of all shapes and sizes to have economic policies that impact and benefit all of the members of our communities,” said Clarence E. Anthony, CEO and executive director of the National League of Cities (NLC). “This fellowship will bring together six different cities to tackle six different inclusion issues. We are excited to partner with these cities to address these challenges and create solutions that will help lead to a more equitable future.”

“Cities are recognizing that creating equitable and sustainable economic prosperity for all should be the goal of their activities across the board,” said Angela Glover Blackwell, PolicyLink president and CEO. “We are excited to be working with economic development leaders who are eager to integrate an equity approach into their efforts to grow strong local economies.”

“We’re excited about the launch of the new fellowship and its significance in helping us create more livable, vibrant, and economically successful cities,” said ULI Global Chief Executive Officer Patrick L. Phillips. “The involvement of community stakeholders in the economic development process is a key part of creating places that are appealing to residents, visitors and investors.”

“At Surdna, we believe it’s essential that cities develop new approaches to economic development

that ensures greater prosperity for all communities. The Equitable Economic Development Fellowship will advance new thinking and best practices that we anticipate will influence the broader field”, said Phil Henderson, president of the Surdna Foundation. “We are truly grateful to partner with the National League of Cities, Urban Land Institute and PolicyLink to launch this ambitious program that will transform economic development practices across the country.”

“All too often, government is challenged in its ability to deliver economic opportunity to the communities that need it most. We are excited about the potential of this fellowship to help bring new ideas and new leaders to the table, and to demonstrate that equity and inclusion can drive economic growth for the many, not just the few,” said Ken Zimmerman, director of US Programs at the Open Society Foundations.

JUNE 28, 2016

[June, Usually the Cruellest Month for Muni Bonds, Is Anything But.](#)

A flood of state and local government debt in June wasn’t enough to dampen a rally in the municipal-bond market.

While states and local governments sold \$44 billion fixed-rate bonds, more than any month since October 2010, the securities returned 1.6 percent, buoyed by steady investor inflows and a flight to the safest assets amid speculation about impact of the U.K. vote to leave the European Union.

It was the best June performance since 2000 and the market’s biggest advance since January 2015, according to a Bank of America Merrill Lynch index. In a sign of the market’s strength, 30-year yields declined 0.15 percentage point the day after England’s June 23 referendum, slightly more than Treasuries. At 3.18 percent, the Bond Buyer’s 20 Year General Obligation Bond Index is at its lowest since May 1965.

“We’re talking about massive issuance and nevertheless deals have been vastly oversubscribed, at least until now,” said Mikhail Foux, head of municipal strategy at Barclays Plc. “People just can’t get enough despite rates actually falling.”

Historically, June has proven to be a weak time for the local bond market because it has the heaviest supply of new bonds. The Bank of America Merrill index has posted positive returns in the month only three times since 2006.

Macroeconomic forces this year combined to push up prices instead. June began with a disappointing jobs report that showed employment growth was the lowest in five years, weakening the case for the Federal Reserve to raise interest rates. It ended as investors took shelter from the fallout from the so-called Brexit. In between, the Fed’s statement that inflation remains below its 2 percent target stimulated demand for longer-dated bonds.

U.S. state and local-government debt funds have taken in cash for 39 straight weeks, according to Lipper US Fund Flows data, the third longest streak. Even before the U.K.’s vote triggered turmoil in markets worldwide, the funds picked up \$1.4 billion in the week ending June 22, the most since January 2013.

Foreign buyers, faced with negative interest rates in their own countries, are contributing to the flood of cash.

With yields at a more than 50-year low, such inflows may be curtailed if investors start looking elsewhere for higher returns, said Matt Dalton, who oversees \$5 billion of munis as chief executive officer of Rye Brook, New York-based Belle Haven Investments.

“There’s just not as much meat on the bone,” Dalton said. “When you’re at a low yield level like we are, at some point you just run out of gas.”

The only part of the muni yield curve that has slightly underperformed is the short-end, said Foux.

Investors should add short-dated bonds and hedge them with Treasuries, he said. Short-dated New Jersey general obligation and appropriation-backed bonds and Detroit Public School bonds are attractive as is zero-coupon debt.

In July and August, the strength of the \$3.7 trillion market may continue as issuance declines and bondholders reinvest debt payments and proceeds from callable bonds. Nuveen Asset Management forecasts \$48 billion will be reinvested in July and \$44.5 billion in August, compared with issuance of \$39 billion and \$37 billion, respectively.

Since the beginning of the year, munis have returned 4.3 percent, or 6.2 percent on a tax-adjusted basis, according to Barclays. That’s better than the 5.4 percent return for Treasuries. The S&P 500 has gained about 2.7 percent.

“All those features in terms of tax exemption, the yield, and negative correlation to equities have attractive characteristics, so they keep putting money to work and that money is coming in globally as well,” said John Miller, co-head of fixed income in Chicago at Nuveen, which oversees \$120 billion of munis.

After Brexit, the Fed likely won’t raise interest rates for the rest of the year, eliminating a risk to the value of outstanding fixed-income securities, Miller said.

Meanwhile, a victory by Democrat Hillary Clinton in the presidential election would also support municipal bonds because she would likely raise taxes, increasing the value of the tax exemption, said Foux. Conversely, a Trump victory would hurt.

“For the most part, I see the market being supported near term,” Foux said. “It’s a defensive asset class. It should perform well in times of stress.”

Bloomberg Business

by Martin Z Braun

July 1, 2016 — 2:00 AM PDT Updated on July 1, 2016 — 4:54 AM PDT

[U.S. Municipal Bond Sales Total Just \\$1.6 bln Next Week.](#)

U.S. municipal bond and note sales will total just \$1.6 billion during next week’s shortened calendar because of the July 4th holiday, compared with nearly \$9 billion this week, according to Thomson Reuters estimates.

The biggest deal on the calendar is from the South Carolina Transportation Infrastructure Bank for

\$204 million of revenue refunding bonds.

Low supply has contributed to strong muni market performance. The 30-year yield on top-rated muni bonds hit another record low on Friday, closing at 1.99 percent, according to Municipal Market Data, a Thomson Reuters unit.

The 10-year yield was 1.34 percent on Friday, just 5 basis points off its the record low of 1.29 percent hit on June 27.

Muni bond issuance levels dropped to \$214.5 billion in the first half of 2016, a 0.2 percent decline from the same period last year.

Fri Jul 1, 2016 5:29pm EDT

(Reporting by Hilary Russ; Editing by Dan Grebler)

3 Ways to Take P3s to the Next Level.

“Blended” models have the potential to bridge some big gaps in infrastructure finance.

Public-private partnerships are the future of public finance. That little sentence can light a fire in the world of public money, which is struggling to find the wherewithal to pay for infrastructure.

For a while now, public-private partnerships (P3s), which let a private entity handle everything from the development and operation of a public project to its financing, have become a standard option to replace roads, bridges, wastewater treatment facilities and other core infrastructure. Recently, there's been talk of using P3s for the reimagining of such icons as New York's Penn Station and LaGuardia Airport, Chicago's "L" train, and the Los Angeles Convention Center.

It has become increasingly clear that P3s are a badly needed alternative to finance projects. One reason: Many states and localities have reached either the end of their political will to take on more debt or their legal limits on borrowing inexpensive, tax-exempt money. Federal law does not permit the use of tax-exempt bonds on a project if more than 10 percent of the money comes from private sources, which is why projects are usually financed with all public money or all private money.

At the same time, there is concern that P3s are giveaways to the private sector. The pushback centers on a contention that many P3s don't shift enough of the financial, operational and political risks onto the private sector.

Despite the unease, there is widespread agreement that the private sector can add value. This is especially true for project management and operations. Private partners don't answer directly to a political process. They can deploy new technology, invest in preventive maintenance, rearrange staffing and bring in new expertise, all without asking permission. Many government infrastructure managers would give anything for that kind of speed and flexibility.

So what's got public finance folks excited about P3s' future? Recent attempts to blend the public sector's access to low-cost, tax-exempt financing with the private sector's expertise and agility. Three emerging strategies are moving in that direction.

One is to bring nonprofit partners into the mix with the goal of allowing private partners to have

financial skin in the game so that they are more excited about managing or operating a piece of public infrastructure.

Here's how this strategy would work: A government and its private partners structure a P3 around a nonprofit corporation. That nonprofit sells tax-exempt municipal bonds to finance most or all of the project, leases the project back to the government and then uses those lease payments to pay off the bonds. Because it's a nonprofit, it can also take money from private-sector investors and write contracts with private partners to maintain and operate a project.

The National Development Council claims to have pioneered this "American Model" of P3s. Seattle's South Lake Union and the Riverside County, Calif., Law Building are good recent examples.

A second strategy is to expand the scope of tax-exempt financing. Under federal law a government can use tax-exempt private activity bonds to finance infrastructure that's managed by private operators — airports and water-sewer systems, for example. However, federal law also limits the size and scope of the private activity bond market. Expanding the amount of private activity bonds allowed and the types of projects they can finance would expand these joint benefits.

A third is for governments to grow their role as lenders. States have a variety of infrastructure loan programs for local governments. The federal government does the same through Transportation Infrastructure Finance and Innovation Act loans and similar programs. Under some P3 models, private partners can access these programs and use them as loan guarantees against other investments. This can help to leverage enough private investment to make a P3 pencil out. The Move America Act legislation now pending in Congress seeks to boost these types of loan financing tools.

Right now these "blended" P3 models are just a small part of the infrastructure finance landscape. But they have potential to bridge some big gaps.

GOVERNING.COM

BY JUSTIN MARLOWE | JUNE 2016

[New Laws Pave the Way for Transportation P3s.](#)

The governors of Louisiana and New Hampshire recently signed transportation P3 enabling bills into law.

Although the Louisiana Transportation Authority already is permitted to use P3s, [Act 519](#), which was introduced as SB 549, extends this authority to the state's Department of Transportation and Development.

The law also stipulates that a quarter of all P3 projects the department conducts must be located outside a metropolitan planning area. This subset of projects must be approved by House and Senate transportation, agriculture, forestry, aquaculture and rural development committees.

The law, which took effect June 13, specifically prohibits the department from accepting unsolicited proposals.

The law also sets up a public-private partnership transportation infrastructure oversight commission, whose members are appointed by the governor and other state officials, to review and

recommend suitable projects to the commissioner. The commission is required to hold at least one public meeting to solicit feedback on draft requests for proposals, followed by a 30-day comment period.

This is the first law the state has enacted authorizing the use of P3s to procure infrastructure projects.

“Senate Bill 549 will help build innovative public-private partnerships that are critical to moving commuter rail forward,” Gov. Maggie Hassan said in a June 16 statement upon signing the bill. She also expressed dismay over legislature’s refusal to include her proposal to build a commuter rail line from Boston to Nashua and Manchester, N.H., in the 10-year transportation plan. Hassan had previously signed into law a [bill](#) authorizing a study to assess the feasibility of using P3s for such projects.

NCPPP

June 30, 2016

[SIFMA U.S. Municipal VRDO Update, June 2016](#)

A brief historical stat sheet to the municipal ARS, FRN, and VRDO market ending June 2016. In excel format only.

[Read the report.](#)

July 1, 2016

[Kroll Public Finance: Special Tax Revenue Bond Rating Methodology.](#)

[Kroll Public Finance: Special Tax Revenue Bond Rating Methodology.](#)

6/17/16

[Kroll Public Finance: U.S. Local Government GO Methodology.](#)

[Kroll Public Finance: U.S. Local Government GO Methodology.](#)

6/17/16

[Kroll Public Finance: Private, Not-For-Profit U.S. Higher Education Rating Methodology.](#)

[Kroll Public Finance: Private, Not-For-Profit U.S. Higher Education Rating Methodology.](#)

6/17/16

Kroll Public Finance: General Property Tax/Assessment Revenue Methodology.

[Kroll Public Finance: General Property Tax/Assessment Revenue Methodology.](#)

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Kroll Public Finance: General Revenue Bond Methodology.

[Kroll Public Finance: General Revenue Bond Methodology.](#)

6/17/16

Kroll Public Finance: U.S. State and Local Government Abatement Lease Rating Methodology.

[Kroll Public Finance: U.S. State and Local Government Abatement Lease Rating Methodology.](#)

6/17/16

Kroll Public Finance: U.S. General Airport Revenue Bond Rating Methodology.

[Kroll Public Finance: U.S. General Airport Revenue Bond Rating Methodology.](#)

6/17/16

Kroll Public Finance: U.S. Municipal Water and Sewer Revenue Rating Methodology.

[Kroll Public Finance: U.S. Municipal Water and Sewer Revenue Rating Methodology.](#)

6/17/16

Kroll Public Finance: U.S. Public Toll Roads, Bridges & Tunnels Revenue Bond Rating Methodology.

[Kroll Public Finance: U.S. Public Toll Roads, Bridges & Tunnels Revenue Bond Rating Methodology.](#)

6/17/16

Colleges Find Attractive Option in P3 Funding.

DALLAS — Cash-strapped colleges and universities are finding public/private partnerships as an attractive avenue for financing student housing and other campus infrastructure projects, according to Fitch Ratings.

The benefits of a P3 financing include an efficient construction process and less operational risk for the school, Fitch analysts said in a new report on college P3s.

“Recent P3s by some colleges have been able to procure funds more quickly and efficiently than traditional sources while offloading risk to the private sector and preserving colleges’ balance sheets,” said Fitch senior director Seth Lehman, chief analyst on the report.

College campuses are like small cities that provide a number of public services that can generate the revenues sought by private investors, Lehman said.

“It’s not for every university,” Lehman said. “The schools have to be willing to give up some control to the private investors, like the ability to set dormitory fees.”

Higher education P3 ratings are likely to fall within the triple-B category but higher ratings are possible for P3s with robust coverage and little cost risk, he said.

“Strong contractors and sufficient third-party security packages can also result in a higher rating for higher ed P3s” Lehman said.

Large public flagship universities with good credit ratings are less likely to turn to P3 financing than are the smaller schools, according to Lehman.

“The larger schools with good access to the municipal market often don’t see that they can justify it but secondary institutions are less certain to find funds for renovations or other infrastructure needs,” he said.

A \$1.14 billion campus expansion project at the University of California at Merced announced in November 2015 could be a model for future higher education P3 projects, Lehman said.

“That’s one that a lot of people are going to be looking at,” he said. “It’s certainly one of the larger ones you’ll see in the higher ed market.”

The UC Merced 2020 Project will be financed with \$600 million of University of California revenue bonds that the UC Board of Regents will be asked to approve in July and \$157 million of UCMerced funds.

Plenary Properties Merced was selected Wednesday as the winning bidder for the 39-year

concession to build and operate almost 1 million square feet of new facilities on the campus located near Yosemite National Park.

Plenary Group, an international infrastructure developer, is the lead partner and equity provider.

The consortium of international financial, engineering, and design partners will contribute \$386 million of equity to the four-year construction effort and receive \$51 million per year of availability payments for 35 years.

The UC Merced project will include classrooms and housing for 1,700 students as well as recreational areas, dining spots and walkways. Work will begin later this year and be completed by 2020.

The new buildings will feature classrooms and meeting spaces on the ground floors and student residences on the upper levels.

The Merced deal is the largest P3 of its kind in the U.S. higher education sector and the first time that the UC system will use a single private development team for a multiyear, multi-building project, said UC president Janet Napolitano.

The work will be completed nearly twice as fast as a traditional public construction project, she said.

"UC Merced is poised to become a model for our other campuses as we look for the most efficient ways to construct, operate and maintain facilities that enable us to pursue our teaching, research and public service missions," Napolitano said.

UC Merced is the newest and smallest full-service campus in the UC system, with 6,685 students. The expansion project will provide space for 10,000 students.

The Bond Buyer

By Jim Watts

June 16, 2016

[After Brexit Rally, Munis to See Low Yields, Strong Demand.](#)

In one of the biggest rallies in recent memory, municipal bonds surged on Friday after Britain voted to leave the European Union.

Yields on some top-rated municipals fell as much as 17 basis points to record low levels. Analysts said the move signaled that yields will remain near all time lows longer than anyone had expected and that negative U.S. interest rates may be on the horizon.

A New York muni trader who has been in the business for over 25 years said that Friday was one of the wildest trading days that he had ever seen.

"The flight to quality was crazy overnight and muni ratios got ridiculous cheap," the trader said. "We pretty much had two types of buyers who came in and bought. We saw the mutual funds who were getting squeezed because they were getting higher coupons getting redeemed and taken out, which forced them to re-invest at lower yields. When they come in, they chase the market. But on top of

that, we saw absolute low yields and attractive relative yields.”

While analysts saw Friday’s trading as just a one-day price movement, they also felt there were longer-term implications looming for the market.

“Today’s rally is an overreaction, no doubt” said Vikram Rai, CFA and head of municipal strategy at Citi. “But there is no doubt that Brexit will mean lower yields for a longer time.”

Rai said Federal Reserve Chair Janet Yellen is very cautious about roiling the financial markets by raising interest rates too early – and that she had waited and bypassed a chance for a June hike in order to study any possible effects of a Brexit yes vote.

Others also saw a cautious Fed ahead.

“With the news, it seems pretty likely you take the Fed off the table now,” said Jim Grabovac, senior portfolio manager at McDonnell Investment Management.

“It is off the table for July [and] unlikely conditions would warrant actions prior to the end of the year,” Grabovac said. “Aside from the near-term shock, over the medium-term I think this will put pressure on rates to remain low and will stay persistent. This could also be seen as a positive for the dollar, and a stronger dollar would pressure U.S. inflation higher.”

Municipal Market Data’s Senior Market Analyst Randy Smolik also said he that a July rate hike by the Fed was probably off the table, but that doesn’t mean the Fed won’t move later in the year.

“There’s no immediate satisfaction,” he said, noting that Britain has up to two years to negotiate a withdrawal from the EU and that a lot could change in that time.

On the buy side, sources stressed both the short- and long-term consequences to the Brexit vote.

“The immediate impact is lower yields and higher dollar prices on most high to medium-quality bonds,” said Michael Pietronico, chief executive officer at Miller Tabak Asset Management in New York City. “We sense 5% coupons will begin to lag as the ultra-high dollar prices will turn retail investors off.”

Pietronico said his firm has long held that negative interest rates were heading to the United States. “We have been vocal on that call for months with our target for this to occur in the second half of 2017,” he said. “If we are wrong on this call it will only be because it happens sooner.”

“The United States economy cannot sustain growth with a strong U.S. dollar and the direct consequence of Brexit will be downward pressure on inflation here in America, and a Federal Reserve [that] will no longer even challenge the notion outwardly of raising rates again.”

According to Friday’s final read of Municipal Market Data’s triple-A scale, the yield on 10-year benchmark muni general obligation fell 17 basis points to 1.36% from 1.53% on Thursday, while the 30-year muni yield declined 15 basis points to 2.08% from 2.23%. Both maturities are now at record low levels. At one point during the day, yields were down by as much as 20 basis points.

Markit said the effects from Brexit vote were felt throughout the market early on Friday, with yields on investment-grade bonds tightening 17 to 20 basis points from previous day’s close.

According to Markit’s evaluated bond pricing service (<http://www.markit.com/Product/Pricing-Dat-Bonds-Municipal>), yields on University of California, 5’s of ’46, tightened by 18 basis points.

And the rally was not isolated to top rated-munis, Markit said, adding that yields on lower rated Loma Linda University Medical Center, 5.25's of 56, tightening 14 basis points as well. Taxable California, 7.6's of 40, also rallied 10 basis points from previous day's levels.

Some analysts see a continued demand from buyers of municipal securities.

"The market for munis has been strong and this will only add to the dynamic," said Dan Heckman, senior fixed-income strategist at U.S. Bank Wealth Management. "I am not surprised the vote went that way, but I was surprised by the margin of Exit; it was a wider win than I thought would occur. What is happening today is a unwinding on the equity side."

Other market strategists agreed.

"I expect business as usual for munis after the dust of today's rally settles," Janney Municipal Strategist Alan Schankel said in an email on Friday. "As low as our rates look (munis and Treasuries), they are still above rates of Euro economies, some of which are negative (Switzerland and Germany)."

George Rusnak, Head of Global Fixed Income at Wells Fargo Wealth Management, saw a fair amount of trading volatility but said that was "both exacerbated and muted by this being a Friday in summertime," when there is typically less trading being done.

He said he was not seeing the market have any liquidity problems, but added there was a bifurcation in munis, with some buyers gravitating toward a risk off trade while other looking moving into it as a risk on trade.

Munis have done very well so far this year, he said, in terms of mutual bond fund inflows and muni to Treasury ratios.

He said the only fly in the ointment might be that low yields are forcing higher pricing and that issuers might have to change their focus.

"They are running into retail resistance," he said, adding that there's a recalibration taking in mindsets, so there may be more issues being priced with lower than 5% coupons.

But most saw strength in munis lasting beyond the day.

"We have lower yields now, but munis are hanging in there," said Dawn Mangerson, senior portfolio manager at McDonnell Investment Management. "I would say hold onto your munis for a little longer, they are a safe haven and a complement to equities."

She added that "positive yield is awesome for foreign investors."

Other analysts agreed.

While there is likely to be global economic uncertainty and global financial-market volatility, Peter Donisanu, global research analyst, and Paul Christopher, head global market strategist at Wells Fargo Investment Institute believe that the domestic impact will be manageable and investors should remain active.

"Outside of limited trade ties, the direct impact around the world is likely to be contained, and we believe that growth in the U.S. economy may slow from 1.9% to 1.7% in 2016," the team wrote in a June 24 global investment strategy report.

“Systemic risks are likely to remain subdued given significant financial tools available to central bankers and the significant amount of global liquidity available,” the analysts wrote. “We believe that it is important that investors look through the uncertainties related to UK’s upcoming negotiations with the EU and remain fully committed and fully invested in their long-term investment plan,” Donisanu and Christopher added.

There are longer-term effects of the Brexit referendum that should be taken into account as well, strategists said.

Rai saw three possible scenarios. Politically the vote could embolden some political parties in other EU countries to also push for a membership referendum. Economically, the impact could result in slower growth in the Eurozone, he said. Slower growth means lower yields, he said, and that could be good for U.S. Treasuries. Financially, it may mean many banks which had moved headquarters to London may move back to the continent, which might hurt bank profitability.

Heckman also saw a possible political danger

“On the long term, if other countries want to make votes to leave the EU, that would be problematic and create volatility,” said Heckman.

The Brexit vote should bolster and support municipal bond prices, especially with a favorable July and August seasonal period on tap, while the long term implications of the British exit from the EU will take time to evaluate, according to Anthony Valeri of LPL Financial.

“The negative economic implications and lingering uncertainty are positive for municipal prices,” Valeri told The Bond Buyer Friday afternoon. “As is typical during flight-to-safety rallies, munis lag Treasuries but are still enjoying broad-based strength — long-term bonds outperforming intermediate, which in turn is outperforming short-term bonds.”

“Despite a strong start to 2016, I don’t envision recent gains fading soon,” Valeri said.

Overall, Valeri said Brexit should reinforce investor demand for high-quality bonds, however, while a flight-to-safety is underway, he said municipals are unlikely to match the pace of Treasury gains. In addition, he said, central banks are now more bond friendly and the Federal Reserve rate hikes before end of year are highly unlikely.

The Bond Buyer

By Chip Barnett and Aaron Weitzman

June 24, 2016

Christine Albano contributed to this story.

[Already Hot U.S. Municipal Bond Market Rallies Further on Brexit.](#)

NEW YORK, June 24 (Reuters) - U.S. municipal bond yields blew through previous record lows on Friday as investors snapped up tax-free debt amid a global flight to safety after Britain voted to leave the European Union.

Yields on top-rated munis fell as much as 20 basis points, with movement especially steep in longer maturities, according to a preliminary read of Thomson Reuters' Municipal Market Data's (MMD) benchmark scale. Bond prices move inversely to yields.

The \$3.7 trillion muni market, most of which is investment-grade tax-exempt debt issued by states and cities, was already on a hot streak with no end in sight, with demand outstripping supply for months.

For 38 straight weeks, investors have poured money into muni bond funds with a net \$30.4 billion added year-to-date. The week ended June 22 had the highest inflows in over three years at \$1.4 billion, according to Lipper data.

Over the past 12 months, munis have returned 7.03 percent versus 5.18 percent for Treasuries, according to Barclays indices.

The "feeding frenzy" for muni bonds is unabated, said Bank of America Merrill Lynch research strategist Philip Fischer.

"Munis are very strongly bid and we've been bullish on the muni market for a long time. We remain bullish," he said, adding: "We expect we will have another new low in muni rates in the next couple of weeks and we'll probably get some profit taking then and rates will go back down before the end of the year."

Low muni yields allow state and local governments to borrow, for infrastructure, school construction and more, and refinance old debt at affordable interest rates.

Yet debt issuance has been low in part because of a lingering austerity mindset among many public officials after the recession prompted painful public sector spending cuts.

Issuance totals \$205.5 billion so far this year, a 2 percent drop over the same period in 2015, according to Thomson Reuters data.

Yields hit lows on June 16 for 10-year and 30-year munis, at 1.42 percent and 2.13 percent, respectively, according to MMD.

MMD data goes back to June 1981, when the yield on a AAA-rated 30-year bond was 10.20 percent.

Some have urged caution because even riskier muni bonds are now expensive.

Even so, investors are not likely to rush to cash out, said Dawn Daggy-Mangerson, director of municipal portfolio management at McDonnell Investment Management.

"Munis are a nice place to put your money until things settle down," she said.

By Hilary Russ

(Reporting by Edward Krudy and Hilary Russ in New York; Additional reporting by Karen Pierog in Chicago; Editing by Daniel Bases and Tom Brown)

[P3 Innovations Cut Costs But Rate of Adoption is Conservative, Study Finds.](#)

Public agencies enter into P3 agreements to reduce a project's construction and life cycle costs, expedite their completion, and improve their efficiency and reliability. In addition to skills and experience, private developers often count on having the flexibility to use innovative techniques and technologies to help them meet these expectations.

Although more than half of the innovations that are typically incorporated into P3 projects are "incremental," they can help to shave 30 percent from a project's costs, especially in transportation and transit projects, a new study indicates.

["Understanding the Effect of P3s on Canadian Infrastructure Projects,"](#) conducted by researchers at the Ryerson Institute for Infrastructure Innovation at Toronto's Ryerson University, reports the results of a literature review of P3 project documents and interviews with 19 people who were associated with 15 successful Canadian P3 projects.

The researchers found that about 60 percent of the innovations these projects included were relatively modest in scope because timely, cost-effective project delivery, not innovation, are procuring agencies' top priority. The relatively short time frame developers have to respond to requests for proposals and the tendency of public and private partners to be risk averse also discourage exploratory approaches to project development. As a result, proven rather than experimental technology tends to be proposed and accepted, the study's authors found.

This finding notwithstanding, many of the requests for proposals Canadian agencies issue encourage developers to propose innovative approaches, although their means of doing so varies. British Columbia and Alberta use very general terminology to attract innovative proposals, for example, while Infrastructure Ontario will issue required or preferred innovation provisions in its RFPs.

The researchers found that the types of new technology or techniques that were introduced, and when, varied by project type. Facility P3s, such as hospitals and court houses were most likely to incorporate innovation in the design rather than construction phase and were often described in the RFP. These new approaches usually involved technological adaptation or changes to respond to the demand for services or to achieve energy or architectural sustainability.

Most innovations in transportation and transit projects, on the other hand, were proposed and implemented after financial close and focused on construction challenges. These changes were often developed to address geotechnical, traffic management and project durability challenges. "This is a good indication that P3s have successfully transferred the construction risk to the private sector," the researchers wrote.

The authors also provided a glimpse into major innovations interview subjects had introduced in specific P3 projects. These included "compact footprint, building orientation and use of spandrel glass panels" to make a courthouse project more green, installing a pneumatic tube system and automatic guided vehicles to streamline a hospital's delivery process, and building cut-and-cover tunnels rather than boring them as part of a railway project.

Almost all of the interview subjects agreed that the procuring agencies accepted proposed innovations based on cost and said that far more proposed innovations were rejected than accepted. Approval was based on the proposed innovation's affordability and ability to enhance performance.

The researchers made several recommendations to public agencies and private developers to encourage innovation and its acceptance in P3 projects. They called on agencies to focus less exclusively on contract compliance and more on addressing the needs a project is intended to address, its preferred functionality, performance and the level of services it is intended to provide.

Private developers were encouraged to focus on projects that involve life cycle development rather than short-term project completion.

The researchers also urged the P3 community to collaborate with universities and applied research centers to spur radical innovation and advised governments to invest in infrastructure research and development.

Finally, they called for more research into innovative ways to finance P3s.

NCPPP

June 23, 2016

S&P's Public Finance Podcast ("Debt Levels Flatline as U.S. States Prioritize Budget Management Over Investment")

Carol Spain, an Associate Director in the States Group out of Chicago, discusses our recently published article "Debt Levels Flatline As US States Prioritize Budget Management Over Investment".

[Listen to the Podcast.](#)

Jun. 23, 2016

The Billions We're Wasting in Our Jails.

By using data analytics to make decisions about pretrial detention, local governments could find substantial savings while making their communities safer.

Few areas of local government spending present better opportunities for dramatic savings than those that surround pretrial detention. Cities and counties are wasting more than \$3 billion a year, and often inducing crime and job loss, by holding the wrong people while they await trial. The problem: Only 10 percent of jurisdictions use risk data analytics when deciding which defendants should be detained.

As a result, dangerous people are out in our communities, while many who could be safely in the community are behind bars. Vast numbers of people accused of petty offenses spend their pretrial detention time jailed alongside hardened convicts, learning from them how to be better criminals.

Ideally, deciding who should stay in jail and who can safely be released would be based on the individual's risk of not showing up for court and his or her risk of committing a crime while awaiting trial. Instead, the deciding factor is often the defendant's pocketbook. Those who have the money for bail — including those who are more successful criminals — get out, while the rest remain in jail. Nearly half of Americans don't have \$400 for emergencies; if they get arrested, they are probably going to stay in jail until trial or a guilty plea. The long-term economic impact of incarceration is an earnings drop of 40 percent.

In this era of big data, analytics not only can predict and prevent crime but also can discern who

should be diverted from jail to treatment for underlying mental health or substance abuse issues. Avoided costs aggregating in the billions could be better spent on detaining high-risk individuals, more mental health and substance abuse treatment, more police officers and other public safety services.

Jurisdictions that do use data to make pretrial decisions have achieved not only lower costs but also greater fairness and lower crime rates. Washington, D.C., releases 85 percent of defendants awaiting trial. Compared to the national average, those released in D.C. are two and a half times more likely to remain arrest-free and one and a half times as likely to show up for court.

Louisville, Ky., implemented risk-based decision-making using a [tool developed by the Laura and John Arnold Foundation](#) and now releases 70 percent of defendants before trial. Those released have turned out to be twice as likely to return to court and to stay arrest-free as those in other jurisdictions. Mesa County, Colo., and Allegheny County, Pa., both have achieved significant savings from reduced jail populations due to data-driven release of low-risk defendants.

Data-driven approaches are beginning to produce benefits not only in the area of pretrial detention but throughout the criminal justice process. Dashboards now in use in a handful of jurisdictions allow not only administrators but also the public to see court waiting times by offender type and to identify and address processing bottlenecks.

Fast-tracking minor cases allowed Tarrant County, Texas, for example, to reduce its jail population by 40 percent; mental-health diversion resulted in \$10 million in savings per year in Bexar County, Texas; and New Orleans reduced crime while witnessing a two-thirds decrease in its in jail population by using risk-based pretrial decision-making and turning to summonses rather than detention for low-level offenses such as disturbing the peace and marijuana possession.

Why isn't every jurisdiction moving toward data-driven criminal justice decision-making? One of us served as a three-term "tough-on-crime" district attorney and the other as a high-ranking state criminal justice official, yet neither of us saw much semblance of a systemic approach. Change that involves multiple stakeholders is hard and requires dedicated leadership. Only a coordinated system can accurately balance community risk and benefit. There will be mistakes. Someone who is released will commit a serious crime. But large-scale pretrial incarceration of minor offenders just creates more crime.

As more jurisdictions realize that what is fiscally responsible is also just, we have the opportunity not only to save money but also to make our communities safer and economically stronger. Data-driven decision-making might not solve all of the challenges of achieving justice, but it's a good place to start.

GOVERNING.COM

BY STEPHEN GOLDSMITH, JANE WISEMAN | JUNE 22, 2016

[**The Tricky Trend That's Blurring Budget Transparency.**](#)

Governments' increasing reliance on special funds can put them in financial and legal trouble.

State and local budgets are based on general fund revenues. The cash usually comes from such primary sources as income and sales taxes, and pays for a wide swath of government services. When

managers talk about “balancing the budget,” they’re almost always referring to balancing the spending and revenues from this repository.

Reliance on the general fund as the centerpiece of fiscal management, however, has growing flaws. This is largely because the general fund is diminishing as the main source of money for governments. Data from the National Association of State Budget Officers shows a fairly steady drop in the portion the general fund makes up of the total — 41 percent in 2014 compared with 52 percent in the early 1990s. In Virginia, the general fund made up 47 percent of the total in 2006 and only 39 percent in 2015.

Some of the drop comes from an increase in bonds and, even more so, federal funds, but there’s also been a slow and steady rise in the size and quantity of special funds that are earmarked for specific purposes and get little attention in the annual budget debate.

The Fiscal Futures Project at the University of Illinois at Chicago (UIC) has pinpointed a number of problems with this shift. Depending on state law, special funds may bypass the appropriations process, and unlike the general fund, money collected and unspent may be retained at year’s end rather than being returned to the general coffers. This makes special funds an appealing target when tough budget times hit. Lawmakers see these plush balances outside the general fund as a means to balance the budget. They may transfer or lend money from the special funds to the general fund.

That leads to additional problems. It is a common tenet of responsible budget management that one-time money be used for one-time expenditures. If these funds are raided, then unless revenues are raised or expenses are cut, the government will still come up short in the next budget cycle.

The movement of money between general and special funds “has reduced the transparency of budgeting,” says David Merriman, a professor at the Institute of Government and Public Affairs at UIC. The cloudiness of the budget picture enables political leaders to boast about a reduction of general fund spending, when spending has just been added to one or more special funds.

States can also put themselves in legal peril by using funds for general purposes that are restricted to a specific use. Just after the recession ended, for example, the Wisconsin Supreme Court nixed the transfer of money from a malpractice fund into the state’s general fund. The state had to pay back the \$200 million along with interest.

New Mexico’s reliance on special funds has led to a host of policy and management problems. As the state auditor pointed out in a February analysis of fund balances, New Mexico had \$4.4 billion in unused balances socked away outside of the general fund at the end of fiscal year 2015. Some of that money is untouchable because of iron-clad restrictions about its use.

The large amounts of unspent money raise questions about whether so much should be in funds that get so little attention. Auditors in New Mexico, for instance, found that a significant amount of money was being retained in revolving funds, which are intended as a cash-flow device for agencies and local governments. Localities are supposed to use this money and then return it so it can be used again. The practice isn’t the problem, but the auditor found that some of the funds had very little lending activity, even though the state faces critical infrastructure needs for which it could be used. For example, \$34 million sat unused in a revolving fund account for rural infrastructure between fiscal years 2014 and 2015. “You can’t justify a loan fund that had no loans out of it,” says Tim Keller, New Mexico’s state auditor.

Keller, who was a legislator for six years before he took over last year as state auditor, spells out the

real-life drawbacks of low-attention money. As a member of the legislature, he helped secure financing to build a dam in Las Vegas, N.M. "I thought that fixing the dam was important and I put my political weight behind it," he says. He wasn't alone. The governor and local legislators "were all taking credit for the dam," he says.

But that back-patting was premature. With less visibility, money outside the general fund can go unspent, particularly when a legislative appropriation only provides partial funding as was the case for the dam. That's because "there's no one constantly monitoring it," says Sarita Nair, general counsel in the auditor's office.

Today, the dam is half finished, the money that was appropriated is largely unspent, the project's opponents have brought a lawsuit to stop its progress and the town still has a water crisis. "You can take credit for funding something, but that's a different question than actually having it built," Keller says.

GOVERNING.COM

BY KATHERINE BARRETT & RICHARD GREENE | JUNE 2016

Pensions Could Get Better ... or Worse.

The average funded status of public pension plans dipped slightly in 2015 and could continue in that direction if plans consistently fail to meet their desired investment rate of return, according to a [new report](#).

The report, released by the Boston College's Center for Retirement Research, found that the average pension plan in 2015 had about 72 percent of the assets on hand to pay its total liabilities. That's down from 74 percent the year before. The decrease can largely be attributed to mediocre stock market returns in fiscal 2015, causing most plans to miss their target rate of return of 7 or 8 percent.

The decline comes even as governments are getting better about paying their pension bills. On average, they paid 90 percent of their pension contributions in 2015 — up from about 86 percent the year before.

The Takeaway: If plans continue to miss their marks, the center predicts that pensions' health could continue to decline to about 71 percent funded by 2020. On the other hand, if market conditions improve, then pensions' funded status could improve to nearly 78 percent. "What happens from here on out depends very much on investment performance," the report concluded.

GOVERNING.COM

BY LIZ FARMER | JUNE 24, 2016

Muni Fund Investors Squeezed as Flattening Curve Reduces Payouts.

Investors who've come to depend on steady income checks from leveraged municipal-bond funds are starting to feel the pinch from the narrowing in the difference between short- and long-term

borrowing rates.

BlackRock Inc., Nuveen Investments Inc. and Eaton Vance Corp. earlier this month made widespread cuts to distributions in their closed-end funds as the cost to borrow to boost returns rose and higher yielding bonds held were called as longer-term rates fell. The three companies are among the biggest providers of closed-end funds.

UBS Financial Services, Inc. said in a June 16 report that it couldn't "recall a period in recent memory when so many funds cut distributions at one time." The cuts, which only affected leveraged funds, ranged from 2 percent to 15 percent, UBS said.

"In the flattening yield curve environment, add in the higher cost of leverage, a lot of these funds haven't been able to maintain their high payouts," said Ryan Paylor, a portfolio manager at Thomas J. Herzfeld Advisors, Inc. in Miami.

Closed-end funds raise a fixed amount of money from shareholders in a public offering, unlike mutual funds, which continually sell and redeem shares. Closed-end funds are traded on stock exchanges and can trade at premiums or discounts to their net asset value. Open-end mutual funds trade daily at their net asset value.

Most municipal closed-end funds borrow short-term and buy long-dated debt. The weekly benchmark for yields in the variable-rate tax-exempt bond market surged in March from 0.02 percent to 0.4 percent as investors tapped muni money-market funds to pay taxes.

In the last 12 months, the three-month London interbank offer rate, or Libor, has increased to 0.64 percent from 0.28 percent. The Federal Reserve raised its target rate for overnight loans between banks in December for the first time since 2006.

The slope of the municipal yield curve has flattened to the lowest in more than eight years as investors, including foreign buyers in search of higher yields, have poured money into municipal bond funds for 38 consecutive weeks, according to Lipper data. While short-term rates have risen, the demand helped push 30-year tax-exempt yields to a record-low of 2.23 percent on June 16.

"Because municipal bond yields are so low, as funds have bonds called away they can't be reinvested at the same rate," said Sangeeta Marfatia, a UBS executive director for closed-end fund research. "They're reinvesting the proceeds at lower rates and that's putting pressure on the earnings too."

On June 1, BlackRock said it cut distributions on 38 of its 52 closed-end muni bond funds, according to a news release. Eaton Vance cut distributions on 11 of 21 funds. Nuveen cut 17 of 55.

The average distribution yield for municipal close-end funds is 5.2 percent, a decline from 5.8 percent at the beginning of the year, Paylor said.

"If we get another rate rise and the curve flattens even more it's going to be really tough to sustain their dividends," he said.

Despite the cuts, share prices have gone up. National, New Jersey and New York leveraged funds were up an average of 10 percent in terms of market returns through June 10, compared to their net asset value returns of 6 percent, according to UBS.

After the "Taper Tantrum" in May 2013, when then-Fed Chair Ben Bernanke jarred bond investors with plans to scale back asset purchases, muni closed-end funds traded at a discount to net asset value of more than 13 percent on average, Paylor said. Now they trade at a 1.7 percent discount.

"Muni investors usually are the type that like to chase returns, especially in the closed-end funds space," Paylor said. "As a result they're pushing these things towards premiums."

Bloomberg Business

by Martin Z Braun

June 23, 2016 — 9:05 PM PDT Updated on June 24, 2016 — 7:15 AM PDT

[ACA Financial Guaranty Sues City of Buena Vista, Virginia.](#)

- **Suit Seeks Payment On \$9.2 million Bond Issue Used to Finance the Building of the Municipal Golf Course, Vista Links**
- **Legal Action Could Result in the Foreclosure of City Property including the City Hall, the Police Department Building, and Vista Links Golf Course.**

NEW YORK-(BUSINESS WIRE)-ACA Financial Guaranty Corporation ("ACA") filed suit today against the City of Buena Vista, Virginia for its default on \$9.2 million in Lease Revenue Bonds issued in 2005 ("Series 2005") to refund debt the City had incurred building the municipal golf course, Vista Links.

Steve Higgs, Principal Attorney with The Higgs Law Firm stated, "ACA has worked with the City of Buena Vista for many years to accommodate its needs, and more recently has worked to come to a comprehensive resolution that would benefit all parties. After 16 months of continued non-payment by the City, ACA has decided to sue the City to force it to renew payments on the money it borrowed, and to demand it comply with the promises it made under the Bond agreements. The failure of the City to pay back its Bonds has already resulted in it being excluded from some state borrowing programs, and is likely to impair future efforts for it to borrow from debt markets as long as it remains in default.

"The City's failure to make its Bond payments could result in the foreclosure of its City Hall, its police department building, and its municipal golf course."

The City of Buena Vista, Virginia issued annual appropriation bonds in 2005 in the amount of \$9.2 million to refund debt the City had incurred to build Vista Links, a municipal golf course. The Bonds are "moral obligation" bonds to be paid back from monies appropriated by the City Council. The City further secured the bonds through a lien on certain city property including the City Hall, the police department building, and municipal golf course, Vista Links. The City also promised to give ACA a first lien on any building to which it moves its municipal services.

In July 2011, at the City's request, ACA and the City entered into a Forbearance Agreement in which ACA allowed the City to reduce its debt payments to 50% of required debt service for five years. ACA agreed to allow the City to defer repayment of this money until 2035-2040, interest free.

In January, 2015 the City Council unilaterally violated the forbearance agreement by discontinuing all payments on the Series 2005 bonds, despite four members of the City Council having voted in favor of the forbearance agreement. The City then offered to settle the 2005 bonds by paying the value of the municipal golf course, City Hall and police department building, a value prohibitively less than the \$9.2 million outstanding.

Mr. Higgs continued, "When the City was having problems in 2011, it came to ACA and asked for help. ACA agreed to reduce the payments by 50%, to be paid back on an extended basis. That's a deal you would be hard pressed to get from any financial institution. Now the City has broken even that promise, and claims it cannot afford to pay the money back. But the City is not pursuing bankruptcy and is still paying all its other debt. That is unfair.

"In the long run, when you factor in the costs of litigation, the potential loss of the municipal buildings and golf course, the impaired ability to borrow in the future, and uncertainty about whether you can trust the City's promises, the City would be better off paying the Bonds. The only way that not paying the Bonds makes any financial sense is if the City was contemplating reverting to town status and have Rockbridge County agree to accept it as part of the County.

"The City is engaging in conduct it would never allow from its own citizens. The City Council should honor its promises and pay back the money it borrowed. Even the City has to pay its debts."

ACA is represented in this matter by Steven L. Higgs of STEVEN L. HIGGS, P.C. in Roanoke, VA.

June 13, 2016 05:30 PM Eastern Daylight Time

[S&P: Debt Levels Flatline As U.S. States Prioritize Budget Management Over Investment.](#)

After a small increase in fiscal 2014, the amount of aggregate tax-supported debt outstanding among the U.S. states declined in 2015. According to S&P Global Ratings' calculations, total tax-backed debt balances outstanding fell by 1.04% compared with 2014. In some states, sluggish economic and revenue growth has limited bonding capacity. But even where legal debt limits aren't a constraint, still-lean fiscal margins have contributed to a general reluctance on the part of many states to add new spending commitments despite low interest rates.

For instance, adding new infrastructure can involve more than incrementally higher debt service costs. Often, it also entails new ongoing spending to operate and maintain new roads or facilities. According to the Congressional Budget Office, it's common for more than half of total spending on transportation and water infrastructure to be for operations and maintenance.

[Continue reading.](#)

14-Jun-2016

[Largest PACE Bond Securitization Completed.](#)

Seventh Securitization of PACE Bonds by Renovate America Totals \$305.3 Million; Brings Company's Total of Widely Marketed PACE Green Bonds to \$1.35 Billion

SAN DIEGO, June 6, 2016 /PRNewswire/ — Renovate America, the largest provider of residential Property Assessed Clean Energy (PACE) financing in the U.S., announced the closing of its seventh securitization of PACE bonds – the largest ever completed to date by any issuer and a designated green bond. The securitization, HERO 2016-2, includes \$305,313,000 in Class A Notes rated AA (sf)

by Kroll and AA (sf) by DBRS, secured by 13,432 PACE assessments levied on residential properties in 31 California counties. The PACE assessments have an average balance of approximately \$24,433, a weighted-average annual interest rate of 7.96 percent and a weighted-average original term of 14.95 years. The PACE assessments were originated between January 2016 and April 2016.

“This transaction is our most successful issuance so far in terms of the level of interest from investors including, for the first time, international investment,” said Renovate America’s CEO J.P. McNeill. “This private capital is directly benefitting homeowners and communities by lowering utility bills, reducing carbon emissions, and creating clean energy jobs. This all comes at no cost to taxpayers.”

The HERO Bond platform is the first asset-backed securities (ABS) platform to solely produce green bonds, with each of the company’s seven securitizations having been assessed by Sustainalytics, a leading provider of ESG and corporate governance research and ratings. The company provided a second opinion that the bonds adhere to the Green Bond Principles, and that the proceeds fund projects with measurable environmental benefits. PACE green bonds have received significant interest in part because they do not fund aspirational or speculative projects; the proceeds have already been invested in projects with verified environmental impact.

“Investor interest in HERO Bonds is growing with each issuance because the bonds provide significant relative value versus bonds of similar credit and duration,” said Renovate America’s SVP for Capital Markets Adam Garfinkle. “Our core investor base remains solid and we add new investors with each transaction.”

Renovate America partners with local governments to provide its version of PACE, the HERO Program (Home Energy Renovation Opportunity), to homeowners who finance a wide variety of product installations to conserve water and energy. These installations include energy-efficient products like HVAC, windows, and roofing; renewable and alternative products like solar; and water efficiency products for indoor systems and outdoor landscaping. HERO is unique in that it provides 100 percent financing for energy and water saving products for up to 20 years with fixed interest rates designed to make payments affordable. Homeowners make payments along with their property taxes, and in the event the property is sold, the remaining balance may be able to transfer to the new owner.

Since 2011, the HERO Program has financed more than \$1.5 billion in home improvements which will save more than \$2 billion on energy bills, conserve nearly 10 billion kWh of electricity, reduce emissions by more than 2.6 million tons, and save more than 4.4 billion gallons of water. It has already created 12,700 jobs across California and had a local economic impact of more than \$2.6 billion.

HERO is the largest and most successful residential PACE program in the United States. More than 415 cities and counties have adopted the program across California, including the cities of Los Angeles, San Francisco, San Diego, Sacramento, San Jose, Fresno, Riverside, Anaheim, Santa Ana, Bakersfield, and San Bernardino, among others. HERO will expand into the states of Missouri and Florida in 2016.

About Renovate America

Renovate America is the leading provider of financing for energy and water efficiency home improvements in the U.S. The company’s HERO Program provides local governments with a comprehensive residential PACE financing solution that also includes consumer protection, business automation software, workforce training and ongoing access to private capital. This unique public-

private partnership offers consumers access to more than 60 types of products that reduce energy and water consumption, without the need for government funding. The HERO Program has received a number of awards including the Governor's Environmental and Economic Leadership Award in California, the Urban Land Institute Best of the Best, and the Southern California Association of Governments President's Award for Excellence. In March, HERO was awarded the U.S. Climate Leadership Certificate for Innovative Partnerships by the U.S. Environmental Protection Agency and was a participant in the 2016 White House Water Summit. Additional information can be found at www.renovateamerica.com and www.heroprogram.com.

Jun 06, 2016, 16:24 ET from Renovate America

Defending Wall Street Fees.

The performance fees that public pension plans pay private equity and hedge fund managers are coming under scrutiny. Some say the high fees aren't worth the returns on investment and complain that many costs remain hidden. Those two points were part of a [critical report last month](#) by the right-leaning Maryland Public Policy Institute on Maryland's hidden Wall Street fees.

Now, the Maryland State Retirement Agency has [issued a lengthy response](#) questioning the institute's conclusions. In a letter published this month by Executive Director R. Dean Kenderdine and Chief Investment Officer Andrew C. Palmer, the system's officials attack the institute's methodology while defending its own financials.

Maryland reported paying \$85 million in performance fees in 2014, but according to the report it may have actually paid more than \$250 million. The policy institute made that estimate by comparing Maryland's disclosed performance fee rate against the rate of performance fees disclosed by New Jersey, which has a similarly sized alternative investment portfolio and fairly comprehensive fee disclosure policy.

But Kenderdine and Palmer say Maryland's \$85 million in reported fees are accurate because New Jersey has been "much more aggressive in its pacing of investments." In other words, the private equity funds New Jersey invests in are designed to start producing returns soon after the pension puts money in the fund. Maryland's private equity funds, however, haven't hit that so-called harvesting period when investments are sold and managers receive performance fees from that profit, said Kenderdine and Palmer. So the performance fees are smaller but could theoretically be larger in the coming years.

Though Maryland's investment performance is lagging compared with most plans, according to Kenderdine and Palmer, they may be better off later. That's because stock market losses in the 2001 and 2008 financial crises left them feeling too exposed to one of the "most volatile asset classes," so Maryland now has less of its investments in public stocks than most other plans. That means that "during periods of strong public equity performance, as has been experienced over the past five years, [Maryland] will lag the peer group," the officials said. But, Maryland "should perform better during periods of market stress."

The Takeaway: The pension system's dispute of the figures in the institute's study shows just how murky the issue of reporting Wall Street fees is. In their response, Kenderdine and Palmer also say they support an [effort to standardize performance fee reporting](#). But they join many public pension officials in arguing that even if Maryland's fees were higher, they would be worth it.

“Large amounts of [performance fees] should be considered a positive result, as this would imply much greater gains to the investor,” they noted.

In other words, the higher a performance fee, according to them, the higher Maryland’s profit from that investment is. While that’s true, many contend that cheaper funds can produce comparable (or better) returns on investment.

GOVERNING.COM

BY LIZ FARMER | JUNE 17, 2016

For Whom the Bond Calls.

Like most bond investors, you probably check your online brokerage accounts two to three times a week. You might brace yourself for alerts advising you that another bond or two is being called. You may flinch, wince and may even shout a few expletives. Welcome to the insane world of zero/negative interest rates whose ramifications are painful.

The global drive for yield has broken all the rules: Europeans, Asians and foreign corporations are buying taxable and tax-free municipal bonds like crazy. The tax status is irrelevant; it’s the yield that matters. The global demand for all U.S. bonds has been insatiable. You may hate U.S. bond yields but foreign investors find them luscious.

Think about it. If you are a German citizen or the cash manager of a German insurance company and have a choice of investing in a ten-year German bund at 0.02% or a ten-year U.S. Treasury at 1.65%, which would you choose? Asked and answered. Plus, capital flows are a simple click away.

With interest rates grinding lower, it’s important to stay on top of your bond positions. A perfect example is municipal housing bonds. These are bonds used to finance multi-family or single family mortgages secured by the payments of the underlying mortgage loans. These bonds raise money for affordable housing. Most states issue such housing bonds. Their credit quality overall is good but there is a downside. When there are mortgage prepayments, unexpended, unused proceeds from the bonds issue—you guessed it—bonds can and will be called. If you paid a premium when you purchased the housing bonds and the bonds get called at par, the yield you thought was locked in wasn’t.

Many of my California clients and I own California State Department of Veteran Affairs Home Purchase Revenue bonds. Bonds were state and federal tax exempt, 3.50% due December 1, 2021. When the bond was issued in 2011 it had serial maturities going from December 2013 to the longest dated maturity of December 2028.

As rates have continued to grind down we looked at which bonds have been called and where we stood in the maturity conga line. We were right in the line of fire. Most bonds in the series have already been called. Even though the 2018-2020 maturities are non-callable, they have caveats: Bonds can be called, “from unexpended proceeds at any date prior to their respective stated maturity dates,” according to the official statement.

As you can imagine, our bonds were selling at a premium over par value, roughly \$110 (\$1,100 per 1,000 face value). Brokers’ bids varied widely and wildly. The low bid was \$107; the high bid was \$109.983. What were the odds that our issue would be called at par? Difficult to say. But we’ve seen

other lower coupon housing bonds called. So the old saying, “a bird in the hand...” We sold our bonds at the high premium and let the new owners worry about losing their premium.

Bottom line: Check your bond positions for call provisions—both those that are clearly stated and those that have unusual call features. If you aren’t preemptive and sell, then your premiums will vanish. ‘Tis the season of low interest rates.”

All issuers—taxable, tax free, corporations, government agencies—wish to lower their net interest costs. Calling bonds is one way to accomplish this. Good for them, bad for us bondholders.

FORBES

MARILY COHEN

JUN 13, 2016 @ 12:18 PM

Marilyn Cohen is founder and CEO of Envision Capital Management, Inc., a Los Angeles fixed-income money manager.

The Case for Favoring Revenue Bonds Over General Obligation Bonds.

General obligation bonds have encountered problems as municipal issuers face rising fixed legacy costs that challenge revenue growth

A municipal bond is a municipal bond is a municipal bond. Anyone who believes that to be true has failed to see the increasingly idiosyncratic nature of the municipal marketplace.

A testament to that fact: The Barclays Puerto Rico Index declined 12% in 2015, and nothing else followed suit. Muni investors were wise not to draw conclusions about the broader market based on the unique case of Puerto Rico.

The need to be discerning doesn’t stop at credit ratings. In fact, it’s important to be selective even among traditionally high-quality credits. Currently, there is a strong case to be made for favoring revenue bonds over general obligation bonds.

GO bonds, which today make up one-third of the investible muni market, historically have been considered among the safest forms of municipal debt. Repayment of GOs is secured by a constitutionally prescribed “general obligation” or “full faith and credit” pledge. GOs are paid out of tax revenues and are deemed to have first priority of payment. But municipalities also must use their tax revenues to cover onerous operating costs, and that can leave less money available to pay debt service.

In the past, the security of the GO pledge was rarely questioned. More recently, however, GOs have encountered problems as municipal issuers face rising fixed legacy costs that are challenging or outpacing revenue growth.

Detroit was the first to call into question the sanctity of the GO pledge. As the city took steps to negotiate its way out of Chapter 9 bankruptcy, the repayment of GO debt became a question of willingness, rather than ability, to pay. The question was raised again in discussions in Puerto Rico. There, GOs’ constitutional priority had given bondholders confidence in their legal remedies should

the commonwealth default. That sense of safety was compromised when a preliminary restructuring plan last year indicated “sacrifice” was needed from all creditors, including holders of GO bonds.

The market has now started to infer potential implications for GO debt in stressed locales such as New Jersey, Illinois and Chicago. While these issuers could raise taxes to meet their debt obligations, such moves are always politically difficult, unpopular and therefore, not easy to implement. The question becomes not whether these stressed locales are able to make the necessary decisions, arrangements and concessions to pay their GO debt, but rather: Are they willing to do what’s necessary? Willingness is much harder to read and analyze than ability, and that means GO bonds have been and may continue to be volatile.

Revenue bonds, on the other hand, are underpinned by a dedicated revenue stream, which essentially eliminates any question around a municipality’s willingness to pay. Monies generated are specifically assigned to pay debt service. The most common types of revenue bonds are essential-service, revenue-generating projects such as toll roads, airports and water and sewer systems, where the money made (via tolls, fees, etc.) is used to repay bondholders. Revenue bonds are not backed by a full faith and credit pledge, but issuers have the ability to increase user rates should the dedicated revenue stream fall short, and traditionally they have done so to ensure full debt payments.

Not only are revenue bonds showing lower volatility than GOs, but at two-thirds of the investible municipal universe, they represent the largest subset of the market. This means ample opportunity for investors. The health care and transportation sectors, in particular, present some attractive income and return possibilities — the former underpinned by Affordable Care Act-induced demand, demographically driven health care needs and merger-and-acquisition activity, and the latter supported by lower gas prices and increased travel.

Looking to the opposite end of the credit quality spectrum, high yield remains another high-potential area of the municipal market. The sector has produced strong results, tobacco in particular, and is outperforming the broad market year-to-date — notwithstanding Puerto Rico. High yield represents an important source of carried interest and, therefore, income.

Municipal high yield is distinctly different from the corporate high yield market. The two, in fact, have been shown to be uncorrelated. In 2015, for example, collapsing energy prices weighed on corporate high yield and contributed to rising defaults. The Morningstar taxable high yield bond fund category lost 4%, while the high yield municipal fund category was up by slightly more than 4%.

Overall, creditworthiness in the broad municipal space is stronger than at any time since the financial crisis. The market also appears well positioned to continue the solid performance it exhibited in 2015 and so far in 2016. But investors should pick their places, conduct diligent credit research and seek to make the most of all the municipal bond market has to offer.

Investment News

By Peter Hayes

Jun 13, 2016 @ 10:52 am

Peter Hayes is head of the municipal bonds group at BlackRock Inc.

Muni Demand Won't Waver Anytime Soon.

BlackRock's municipal group said any seasonal pullback in the market this month should be seen as restoring value and presenting a buying opportunity.

Entering June, BlackRock shortened duration in its portfolio in recognition of the market's strong run and increased gross issuance. Issuance generally picks up meaningfully in June, the market's worst-performing month over the past five years, but considering the uptick this May, the usual pattern may not fully develop, BlackRock wrote in its monthly municipal market update.

"On balance, we would see any pullback as healthy, short lived and a potential buying opportunity," the report said. "We continue to favor the A-rated space, revenue bonds and the health care and transportation sectors."

In a presentation to reporters Wednesday Peter Hayes, managing director and head of the municipal bonds group, pointed to the strong demand.

"We are seeing a lot of non-traditional buyers have [become] interested in the asset class as well just because global rates are so low and in many cases, negative," he said.

"\$28 billion coming into the asset class this year alone is phenomenal but it is not sustainable," said Blackrock Director Sean Carney, head of municipal strategy. "Because of what is driving it, we don't see any catalysts that will change it. Fund flows are the product of past performance and future rate forecasts. Performance has been better than good and future rate forecasts are sideways to lower."

Carney noted the deals have been digested easily and oversubscribed as issuance picked up, as sellers offered a something for everyone with bonds that are evenly distributed across the credit curve.

"2016 issuance is still running about 19% above the five and 10 year average, although its true its down about 7% year over year but we are still on track to end the year around \$400 billion and we are about to enter a strong seasonal pattern," Carney said. "Coupon payments will be coming in soon and get re-invested in the market, come July and August."

Illinois, which still doesn't have a budget, is going to access the market with only a minor penalty on yields, the Blackrock strategists said.

"I think it has gotten some attention but the struggle over what is preventing the budget from passing to me is more indicative of the broader market and more problematic of things you might see going forward," said Hayes.

Yesterday, Illinois announced plans to borrow \$550 million on June 16. The Prairie State is currently the lowest rated U.S. state.

"We as municipal market participants should really be penalizing in some way, by almost not giving them any access to the market," said Hayes. "Think about it, they are a state without a budget, they refuse to pass a budget, they have the lowest funded ratio on their pension of any state, and yet they're going to come to market and borrow money."

Carney said the strong demand has reduced the penalty for fiscal problems.

"Spreads have widened quite considerably," he said. "There are a few ways to look at it. One way is that you see the spreads widening but another way to look at it is that with rates continuing to fall, even though they are coming in at wider spreads, the all-in interest cost is not that much greater than where they were, when they previously issued."

The Bond Buyer

By Aaron Weitzman

June 8, 2016

[Yield On 10-year Muni Bonds Drops to Record Low 1.42 pct.](#)

The yield on top-rated municipal bonds due in 10 years dropped to 1.42 percent on Thursday, joining 30-year bonds in reaching record lows on Municipal Market Data's benchmark triple-A scale.

The five-basis-point fall in the 10-year yield pushed it below the previous record low of 1.47 percent set in November 2012, according to MMD, a unit of Thomson Reuters. The 30-year bond yield continued its recent move to all-time lows, ending Thursday at 2.13 percent.

The market where states, cities, schools, and other municipal issuers sell bonds has been in rally mode as cash-heavy investors chase low supplies of debt.

Reuters

Thu Jun 16, 2016 3:48pm EDT

(Reporting By Karen Pierog; Editing by Dan Grebler)

[Illinois Dodging Boycott as Bond-Market Vigilantes Lose Punch.](#)

Illinois can thank plunging global interest rates for saving the state from the consequences of its spreading financial disarray.

The state sold \$550 million of bonds on Thursday for a top yield of about 4.1 percent on securities due in 2041, or about 2 percentage points more than benchmark debt, according to data compiled by Bloomberg. Illinois's first offering since January came after yields on German and Japanese debt slipped deeper below zero and Treasuries veered back toward levels not seen for more than half a century at least.

Rock bottom payouts have sent money pouring into state and local debt as investors search for even modest returns, which allowed Illinois to borrow easily from bond buyers once referred to as vigilantes for imposing discipline on spendthrift governments.

"It's obviously a very favorable environment to sell anything, Illinois included," said Matt Fabian, a partner at Municipal Market Analytics, a research firm based in Concord, Massachusetts. "People are more worried about yields going negative than they are rising, so there's clearly demand for strong positive yield like in Illinois."

The worldwide rally has pushed Illinois's 10-year yields down over the past three months by more than a quarter percentage point to 3.3 percent, despite a record-long budget impasse that caused Moody's Investors Service and S&P Global Ratings to downgrade it last week to the lowest level for a state in over a decade.

BlackRock Inc.'s Peter Hayes, who oversees \$119 billion of municipal bonds for the world's largest money manager, suggested investors consider not buying Illinois's debt to pressure elected officials, a call that didn't keep the state from returning to the market.

"Clearly the political inaction has soured the taste for many investors," said Gabe Diederich, a portfolio manager in Menomonee Falls, Wisconsin at Wells Fargo Asset Management, which manages about \$39 billion of munis, including Illinois debt. "Investors will lend them money again at a very steep penalty relative to the rest of the market, but with the expectation that ultimately the state will take the appropriate steps to fix their issues."

Governor Bruce Rauner, a first-term Republican, and the Democrat-led legislature have been unable to agree on a budget since temporary tax-increases expired last year. Stop-gap measures to keep the government running have left it spending more than it brings in, with a deficit of as much as \$6 billion projected for the year ending June 30. The political discord has also kept Illinois from finding a way to pay down its \$111 billion pension-fund debt, which is the biggest among U.S. states.

Moody's lowered Illinois's credit grade on June 8 to Baa2, two steps above junk and its lowest for a state since Massachusetts in 1992. S&P followed the next day by cutting the state to BBB+, one rank higher than Moody's. Fitch Ratings warned it may downgrade Illinois, too.

The diminished standing on Wall Street has extracted a cost, preventing Illinois from capturing the full benefits as municipal-market rates hold at the lowest since 1965. The 10-year portion of the bonds sold Thursday yielded 1.86 percentage points more than benchmark debt, according to data compiled by Bloomberg. Bank of America won the bonds after an auction among underwriters.

Rauner, a former private equity executive, told reporters in Chicago on Tuesday that bond buyers support reforms he has pushed as a way to stoke the Illinois economy. Since he took office, Rauner has tried to tie any spending plan to changes in Illinois worker-compensation laws, property-tax reductions and limits on unions, an agenda that's drawn opposition from Democrats who say it would hurt lower-income residents.

"They're fed up with the financial mismanagement of the state of Illinois," Rauner said, referring to investors. "This has been going on for decades."

Still, Illinois remains investment grade and isn't seen at risk of default. Illinois law gives debt service priority over other expenditures and requires the state to make monthly deposits for interest and principal payments. And given the decline in yields around the world, Illinois may look appealing.

Investors have added money to municipal-bond mutual funds every week since October, the longest stretch since 2010, Lipper US Fund Flows data show. At the end of March, foreign buyers held a record \$89.2 billion of state and local debt, almost triple what they owned a decade ago, according to the Federal Reserve Board.

"Instead of just on the surface saying no to potentially deteriorating credits, they're going to take a really hard look because that's the only place to go to get any kind of yield in the public fixed income markets," said Adam Buchanan, senior vice president of sales and trading at Ziegler, a broker-dealer in Chicago. "Borrowers will benefit from that, no doubt."

By Elizabeth Campbell

June 16, 2016 — 2:00 AM PDT Updated on June 16, 2016 — 8:59 AM PDT

[Going Green: Evolution of Renewables ABS Discussed.](#)

Representatives from Renovate America, Kramer Levin and T-Rex recently discussed the development of the renewables ABS market during a live webinar hosted by SCI ([view the webinar here](#)). Focusing on the PACE and solar sectors, this Q&A article highlights the main talking points from the session, including structuring and performance considerations. For a broader and more in-depth exploration of these themes, download a special SCI/Renovate America research report on green securitisation.

Q: How has the renewables ABS sector evolved?

Craig Braun, md, capital markets at Renovate America: Beginning with the PACE sector, Renovate America was able to complete the first securitisation in the space in 2014 in a transaction of just over US\$100m. We followed this issuance up with six further deals since then and plan to be an active issuer in the ABS space for years to come. In total, we've completed over US\$1bn of green bonds that meet the Green Bond Principles of 2015.

PACE is a common form of financing that can be paid back via a voluntary assessment on an annual property tax bill. It has a lien priority that is equal to all other taxes and assessments, which makes it a low-risk asset class from an investor and rating agency perspective.

PACE is a public-private partnership, whereby a PACE provider teams up with a municipal issuer, such as the County of Los Angeles. The municipality uses its bonding ability to issue limited obligation improvement bonds that are backed by the various assessments put in place by PACE providers.

Homeowners can apply for PACE financing to upgrade their HVAC systems, or install solar panels or water conserving measures. There are 55 different product categories that qualify for PACE financing and over a million products within those categories, but the improvements must be energy-efficient, renewable energy-generating or water conserving. For instance, the Californian regime heavily promotes water conservation and even includes seismic protection, while Florida provides for wind protection.

PACE empowers homeowners to make the right choice and the smart choice by providing them with a tool to pursue these improvements with no money out of pocket.

California is by the far the most active state out of the 32 states plus Washington, DC that have implemented PACE legislation. In terms of total PACE volume, around US\$1.5bn has been originated so far. HERO, our platform, is available throughout California and will soon be available in Missouri and Florida.

Benjamin Cohen, ceo of T-Rex: The other main renewables ABS asset is solar, which can be purchased via PACE, as well as through power purchase agreements, loans and leases. There has been a 65% compound growth rate in residential and commercial solar panel installments in the US over the last decade, facilitated by improved technology. Technology has enabled the cost of solar

power to drop from US\$40 per watt four years ago to 60 cents per watt today.

SolarCity and Sunrun have been at the forefront of the development of solar ABS. We have seen seven solar ABS issued to date – six by SolarCity and one by Sunrun. The majority of these deals securitise power purchase agreements and over time the deals have increased in size and in yield as investors become more comfortable with the asset class.

One issue you find with solar and not with PACE is tax equity. Tax equity is derived from the investment tax credit, which typically provides 30% of the capital stack and is incredibly complex – but not impossible – to structure around in a securitisation.

Q: In terms of structuring, what are the differences between PACE bonds and regular ABS?

CB: The main difference is that the underlying asset is a tax lien and those are bundled up into limited obligation improvement bonds, which serve as the collateral for the securitisation. The interesting aspect of the PACE assessment is that, like most taxes, the only money that's due is the annual or semi-annual tax payment.

If there is a default or a foreclosure, the principal balance does not accelerate. This is a unique feature of the asset class, which isn't widely appreciated. The only thing that is at-risk during a foreclosure is the tax payment due during that period.

If a homeowner doesn't pay their taxes, they're subject to a penalty – which in California is 10% of the tax due – and after a certain number of months interest begins accruing at 1.5% a month. In the event of delinquencies, there's actually more cashflow available to a PACE deal than if the property owners default on their mortgage payment.

That being said, PACE delinquencies are very low – people tend to pay their taxes, and people with PACE assessments tend to perform better than the average tax payer because they're somewhat of a self-selecting pool. These are people that are investing in their homes and seeking to reduce the cost of ownership.

Finally, the servicer on PACE deals – certainly in the case of the Californian regime – is the county in which the assessment is being levied. Typically in securitisations, the servicer is an affiliate of the originator or the B-piece buyer. So, in the case of the HERO platform, 28 different servicers are billing and collecting the taxes.

Laurence Pettit, partner at Kramer Levin: Both the solar and PACE asset classes have initially struggled with educating investors as to how servicing works. In the ABS world, we're used to the servicing process being done in a certain way, but in both solar and PACE there are unique aspects to servicing.

In solar, as there is some ongoing maintenance involved on the solar installations and because historically there weren't many companies involved in the sector, the idea of there being a back-up servicer was challenging. In PACE, the challenge is parsing out the different servicing roles: as well as the counties which handle billing and collecting, other servicing duties are performed by the trustee, while the municipality is responsible for foreclosures.

Other than that, the structuring differences are fundamental because PACE is a tax and thus has a benefit from the lien perspective and is secured by the entire property, which is not the case with rooftop solar ABS. In terms of cashflows, you can look to tax lien ABS for comparable payment history and you can access data from counties on how often people are delinquent on their real estate taxes. In the case of California, where limited obligation improvement bonds have been

popular for years for other purposes, there is also an indicative history of how those bonds have performed.

Rooftop solar is novel in many respects. We know how diligently people pay utility bills, but the extent to which you can apply that payment history to rooftop solar was open to question from rating agencies and investors. But over time a consensus has formed on how that should be analysed and, as more deals are done, we're starting to develop our own payment history for the bonds – which will provide a significant benefit as the years go by.

Q: California accounts for the majority of PACE assessments currently in place. What are the challenges of expanding the PACE programme into other states?

LP: The initial challenge is something that none of us in the ABS world are very familiar with and it involves state-level politics: each state has its own priorities and legislative issues to deal with. That being said, there is a huge take-up nationwide of PACE legislation – so, despite having to navigate each statehouse separately, PACE is gaining traction because it is popular with both elected officials and consumers.

It resonates with elected officials because the Californian experience has shown PACE to have a tremendous economic stimulus, and it's popular with consumers who embrace new ways to finance home improvements. Seeing as consumers vote for elected officials, PACE creates a virtuous circle.

The most significant attraction is that PACE has a measurable impact on the use of renewable energy and on energy savings. In addition, although it provides a public benefit, it doesn't cost the public sector any money because whoever is hired as the programme administrator (such as Renovate America) will be responsible for ensuring that funding is in place for the improvements installed using PACE.

The programme administrator also has to find an investor to buy the individual assessments or the improvement bonds that are backed by the assessments. There is no period of time during the origination process where the sponsoring municipality has to use its own funds to pay for any of the programme costs.

Renovate America and others have proven that PACE assessments are an interesting asset for ABS investors, but they derive from municipal finance and marrying some legal and contractual concepts from muni finance with the expectations of ABS investors can be a challenge. Therefore it is important to be involved early and scrutinise the contracts and agreements, and the underlying muni bond indentures to ensure they comply with the expectations of an ABS investor and that they provide for contracted cashflows to be paid from the consumer all the way to the ABS investor.

There are always wrinkles in each state that need to be addressed or at least understood before a programme is launched to ensure there's an efficient means for collecting the tax. Clearly California is a good example.

There also needs to be a clear legal framework that tells you as an ABS investor at what point someone has the right to enforce on a delinquent property owner and that there is someone monitoring the process, who will enforce the remedies where necessary.

Q: Why is the scalability of PACE platforms an advantage?

CB: Once you get beyond the political and legislative challenges, with a tech-enabled platform, the PACE business is highly scalable. We estimate that the opportunity for PACE in the US is an annual market of US\$159bn in home improvements, which either reduce energy or water consumption, or generate renewable energy.

California represents about US\$22bn of this opportunity and so far we've just scratched the surface in the state. If you translate this across other states, there is a huge opportunity – especially considering residential properties account for 20% of US energy consumption and, of that, HVAC systems represent 40%.

However, there are a number of barriers to entry. Each programme administrator has to work in each state and get the issuers lined up and then get each community to the stage where consumers can opt into a PACE programme. It's a lot of hammer-and-chisel work upfront, but once the infrastructure and the contractor (point of sale) network is in place, the platform can easily be scaled up.

Q: How do commercial PACE financings differ from residential PACE financings? Can we expect any term securitisations in the commercial space?

LP: Residential and commercial programmes are almost exactly the same, except that the improvements/projects are larger in the commercial sector and can be more complicated. They tend to require accommodation or negotiation with the property owner/commercial mortgagee and that makes the origination process more time-consuming.

It is just a question of time before commercial PACE programme administrators can put together portfolios that are suitable for securitisation. It is taking time for commercial property owners to realise the benefits of participating in commercial PACE programmes.

Unlike residential consumers, commercial property owners have multiple options available to them and are more cautious on adopting PACE. But the popularity of commercial PACE is growing and there are no structural or legal reasons why there can't be term securitisations of commercial PACE – it's more about accumulating an appropriate pool.

Q: In terms of refinancings, do lenders typically require PACE obligations to be repaid prior to the new funding?

CB: Yes they do. The options for a homeowner are either to pay their PACE obligation off, have it transferred to the new property or apply for a limited subordinate PACE product, which we call PACE 2.0. Any time there is a problem with a homeowner in terms of a refi, we have a dedicated group of property advisors that work with realtors and mortgage brokers to facilitate the sale or transfer.

Q: How should investors evaluate risks in solar and PACE securitisations?

BC: There are a handful of risks to be aware of: the typical prepayment and refinancing risk; if there is a default, what is the lag before payment; and what recoveries can be expected. A lesser risk is creditworthiness. Investors have to figure out the likelihood of these risks occurring across an entire portfolio under various scenarios.

The risks become more complex for solar ABS, but also more transparent. An additional risk for solar is how many hours of energy will be produced by the installation. It is necessary to evaluate the characteristics of the solar panel itself, as well as the purchase/lease/loan agreement.

It is also important to look at forward power market conditions – especially when evaluating residual positions – because many contracts are for 20 years, yet the life of the panel will likely last for 40 years. Understanding these risks is critical for liquidity and access to capital.

Q: In general, how have PACE securitisations performed?

CB: Renovate America has only issued six deals and two of our competitors have done a deal each, but they were pure private placements and so there's limited information publicly available. With

respect to our transactions, delinquencies tend to rise just after the tax payment is due – because sometimes people forget to pay or they have other issues – and then trend downwards.

For the HERO Funding Trust 2014-1 and 2014-2 deals, delinquencies for the 2014-2015 fiscal tax year are averaging just under 40bp. On the 2015-1 and 2015-2 deals, for the 2015-2016 fiscal tax year, delinquencies are a little over 2%. Overall Californian tax delinquencies are on average double that figure, so the transactions are showing very good performance.

Q: Have solar securitisations performed as well as expected?

BC: Solar securitisations have performed better than expected across a few different metrics, including the default rate applied by rating agencies. While more solar securitisations have been issued than PACE securitisations, the total volume of securitised solar assets is lower and so the sector also has limited data points.

Without adequate tools and confidence in the numbers, rating agencies have taken conservative assumptions towards solar. But all the data that has come in over the brief 2.5 years since the first deal in the space shows that default rates are incredibly low – a fraction of what the rating agencies expected them to be – and all the note ratings have been affirmed thus far.

Another good indication of the performance of solar ABS deals is how the securities trade in the secondary market. A great example is SolarCity's first securitisation: it was rated triple-B plus, with a seven-year WAL, and priced in November 2013 at a spread of swaps plus 265bp. Eight months later, its third deal priced at plus 180bp, with a higher advance rate but the same rating and WAL.

A secondary trade of the first deal was subsequently executed at similar levels. Such spread compression reflects the fact that investors are becoming more comfortable with the asset class and the collateral is becoming more seasoned.

Q: Looking ahead, how is the recent extension of the investment tax credit (ITC) likely to impact the solar sector?

LP: The ITC was extended in December 2015 as a 30% credit for residential and commercial solar projects until end-2019, after which the credit drops year by year. The decreases are to 26% in 2020, 22% in 2021 and then permanently to 10% for commercial solar and zero for residential solar. The Solar Energy Industries Association projects that the extension of the credit will result in 50%-55% additional installation capacity, compared to what would have been expected without the extension.

The association is projecting the installation of 98 gigawatts of solar power by end-2020, which is enough to power over 20 million homes. This is, of course, good news for the solar ABS market and indirectly for PACE providers as well.

Q: What are the prospects for tapping the European investor base?

CB: We view the prospects as bright: we're hoping to attract European investors to the US PACE ABS deals we're issuing. We're aiming to provide additional supply this year and recently had our first four HERO deals verified as being in alignment with the Green Bond Principles. This means that the HERO programme is the first ABS platform to issue solely green bonds and the first entirely green bond platform in the world.

PACE aligns nicely with green bond principles because the energy savings/impact is known upfront. We recognise that the European investor base has certain pockets of money that are dedicated to green investment. We plan to take the HERO programme on the road to Europe and meet with investors at the Global ABS conference in Barcelona.

We're unfamiliar with the legislative landscape in Europe, although PACE can work anywhere – it's a matter of having the enabling legislation in place.

Q: Will PACE cannibalise current renewable energy type-deals?

BC: It can and it has. Because PACE is such a straightforward structure and is very easy for investors to understand, you see Renovate America as a market leader originating tremendous volume in a short space of time. Other renewables finance companies have typically struggled to replicate the efficiencies of PACE and so there is significant opportunity to grow its market share, both in the US and – with appropriate legislation – beyond.

Structured Credit Investor

Monday 13 June 2016 11:04 London/ 06.04 New York/ 19.04 Tokyo

[Insurer Threatens to Seize City Hall After Muni Bond Default.](#)

The Blue Ridge mountain hamlet of Buena Vista, Virginia, is in danger of having its City Hall, police headquarters and municipal golf course seized for defaulting on its debt.

The city, with 6,600 residents, has failed for more than a year to make payments on \$9.2 million of debt that's insured by ACA Financial Guaranty Corp., the company said in a statement Tuesday. The securities are a "moral obligation" paid with money appropriated by the city council and secured by the golf course and municipal buildings, according to ACA, which said it filed suit over the default.

"The city's failure to make its bond payments could result in the foreclosure of its City Hall, its police department building, and its municipal golf course," Roanoke attorney Steve Higgs, who is representing the company, said in the statement. "The City Council should honor its promises and pay back the money it borrowed."

It would be highly unusual for a city to lose its buildings because of a bond default, highlighting the risk of municipalities putting their credit on the line for speculative projects. Even in municipal bankruptcies, such as Detroit's, residents are protected from having government assets sold off to satisfy creditors, as is routinely done when corporations collapse.

The golf course has been a money-losing proposition since 2004, running up losses of \$3.2 million, according to Buena Vista's annual report. It didn't lead to the development of nearby real estate, as the city expected, nor did it draw enough players to cover its costs.

ACA said that in July 2011 it agreed to let the city cut its debt payments by half for five years, but in January 2015 Buena Vista stopped paying altogether.

The city stopped making payments to support the debt service "when it became clear that essential government services would have to be drastically slashed," Brian Kearney, the city's attorney, said in a statement. He said ACA has been unwilling to negotiate a reasonable settlement.

"All bond holders have been paid in full because the city purchased payment insurance from ACA," Kearney said.

Bloomberg Business

by Darrell Preston

June 14, 2016 — 10:34 AM PDT Updated on June 14, 2016 — 2:17 PM PDT

History Not a Guide for Possible Chicago Public Schools Bankruptcy.

Only four school districts have declared Chapter 9 bankruptcy in the past 62 years, and two of those abandoned the process, says a municipal bankruptcy expert asked about the possibility of Chicago Public Schools doing the same.

CPS, the nation's third-largest school district, faces a nearly \$1 billion budget deficit and the possibility of staying closed in the fall if the state fails to pass a budget.

Rather than compromise with legislators over education funding, Gov. Bruce Rauner has publicly supported a bill introduced by Rep. Ron Sandack that would allow Illinois school districts and other local units of government access to Chapter 9 of the federal bankruptcy code.

James Spiotto, managing director of municipal finance consulting firm Chapman Strategic Advisors LLC in Chicago, points out that only four school districts have filed for Chapter 9 out of 322 total filings since 1954. He adds that two of those dismissed their cases in favor of other resolutions.

"The reason for that is there are better methods that states have developed to deal with troubled school districts," Spiotto said.

"School districts are so important to the economy, the community and the citizens that states have developed mechanisms to monitor, supervise, provide oversight, and if necessary, change the superintendent or board."

He explains that the San Jose School District in California filed for Chapter 9 in 1983, after a contract dispute with teachers that resulted in an arbitration award that the school district couldn't afford.

The school district used the process to resolve the dispute and dismissed the bankruptcy without a plan of debt adjustment less than a year later.

Spiotto says Richmond Unified School District in California filed for Chapter 9 in 1991, and announced that it would close several schools. But after students' parents filed a lawsuit to prevent the closings, the state legislature gave the school district \$29 million to bridge its gap in funding.

The school district hired a new superintendent and dismissed the bankruptcy without a plan of debt adjustment later that year. It also changed its name to West Contra Costa School District.

Spiotto contends that the other two school districts that have filed for Chapter 9 in the past 60 years - Copper River School District in Alaska and Chilhowee R-IV School District in Missouri - are too small to serve as examples for larger, urban school districts like CPS that may consider bankruptcy.

He says that Copper River only had 511 students and six schools when it filed for Chapter 9 in 1986. The school district rejected the teachers' union contract because it couldn't pay salaries, but in the plan of debt adjustment, the salaries were frozen and significantly reduced.

Spiotto adds that Chilhowee R-IV filed for Chapter 9 in 1992, after five former teachers won a

\$200,000 judgment against the school district. The school district only had an annual budget of \$650,000 at that time.

“Chapter 9 really just deals with debt adjustment,” Spiotto said. “Chapter 9 cannot interfere with the property, government and affairs of the municipality, which can be a school district, without the consent of the school district. So the school district would still control its operations.”

“Since you don’t reach issues of operations, you don’t reach issues of academics and performance and achievement,” he added. “Those are other critical issues, so Chapter 9 really is not a holistic approach for a school district.”

Spiotto contends that major school districts should instead consider state-sponsored resolution mechanisms rather than bankruptcy. For example, he says, California allows state takeover of school duties with an appointed administrator and enables the school district to receive emergency loans from the state general fund.

In Ohio, he says, an academic distress commission helps school districts develop a recovery plan when their academic performance is low. The commission can reassign or appoint school administrators, terminate contracts and develop budgets.

Spiotto points out that Illinois takes a different approach. The Illinois State Board of Education can take control of troubled school districts in cities of less than 500,000 inhabitants, but that obviously doesn’t apply to CPS.

“They are separate from any oversight, or setting up a physical oversight panel to review them, which other school districts do have in Illinois,” Spiotto said. “Because of the separateness of Chicago Public Schools, it’s left to the control of the city.”

Spiotto suggests that Illinois set up an oversight authority for CPS that could help the school district with its funding. The authority would provide interim financing and determine what is affordable for the school district, recommend to the legislature additional tax sources or increases in tax limits and ensure that academic achievement continues to improve.

Ted Dabrowski, vice president of policy at the Illinois Policy Institute, points out that the State Board of Education has taken over a few failing school districts, including East St. Louis and North Chicago, but the results have been mixed.

“The biggest issue is that you have one large bureaucracy stepping in to take the place of another bureaucracy,” Dabrowski said. “While that might fix some of the financial problems, it doesn’t really address the true question, are they helping student outcomes and are we seeing better education for children?”

While Chapter 9 bankruptcy might temporarily improve CPS’ finances, Dabrowski also contends that Mayor Rahm Emanuel and the Chicago Board of Education have not made tough decisions on how to use taxpayer money more efficiently and properly provide funds for school programs and teachers’ salaries and pensions.

“I would say that a state takeover will only help when there is pension reform and when the Chicago Teachers Union is forced to back off of its unrealistic claims and demands,” he said.

Spiotto says despite the “theater that you read about in the newspapers,” he wouldn’t rule out CPS and the teachers reaching a resolution for the sake of students and the community.

"They work through the problems," Spiotto said. "That is the best solution. And if they need help from the state, that could help them bridge the financial problems that school districts obviously find themselves in from time to time."

FORBES

BY AMANDA ROBERT

JUN 16, 2016 @ 10:01 AM

Trail of Defaults Leads to Dark Corner of Tax-Exempt Bond Market.

When Philip J. Kennedy needed financing to buy low-income housing in a wealthy Dallas suburb, he bypassed Texas agencies for a tax-exempt bond issuer 700 miles away in Gulf Breeze, Florida.

Leaving the state allowed Kennedy's non-profit American Opportunity Foundation Inc. to secure \$35 million to buy Garden Gate Apartments in Plano, Texas, and a development in Fort Worth without answering questions from local authorities about AOF's past difficulties repaying debt.

Scores of non-profit organizations like AOF are required to use government-created agencies when selling bonds. In return, the agencies charge fees. At times, these conduits aren't in the same state as the projects they're financing, giving officials on the ground little incentive to scrutinize the deals.

It's all perfectly legal. But for investors, it can be risky. Such conduit deals account for nearly 60 percent of the defaults in the \$3.7 trillion municipal-bond market, according to Municipal Market Analytics. In most cases, bondholders, not taxpayers, are on the hook if the projects flop.

Default History

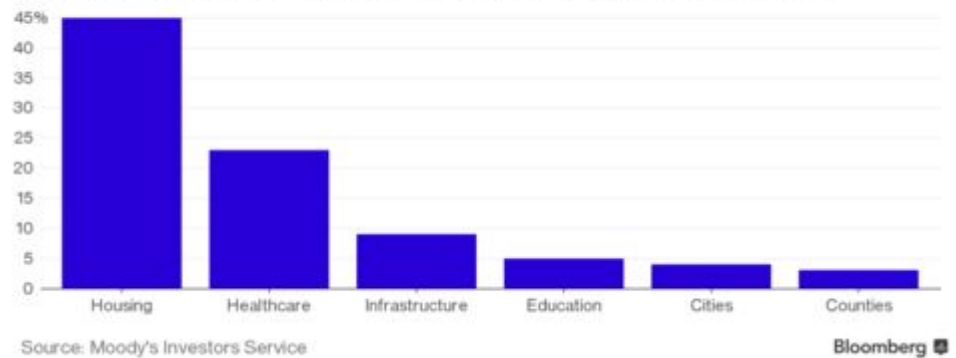
Between 2000 and 2004, Kennedy's AOF defaulted on 14 of 18 outstanding municipal bonds issued in the 1990s, affecting about 5,550 units, according to data compiled by Bloomberg. In 2014, AOF defaulted on bonds issued by a Texas affordable-housing agency to buy apartments in Houston, Dallas, and San Antonio. More than 1,700 apartments lost their subsidies, and rents at one complex climbed 22 percent.

Kennedy, 62, didn't disclose AOF's default history in materials submitted to Plano, and the town council didn't ask him whether any of his projects had failed, according to a video of the meeting. The Florida agency that issued the bonds said its due diligence indicated that AOF "know what they're doing."

"If they had gone through the Texas finance authorities, like the state one, maybe someone at the state would have questioned whether they should be approved or not," said Plano resident Jim Dillavou, a retired Deloitte LLP partner and critic of the city's plan to develop more apartments. "By using a Florida outfit they avoided that scrutiny."

Housing Bonds Lead Municipal-Market Distress

Sector Accounted for Almost Half of Defaults by Moody's Rated Bonds Since 1970



In an interview, Kennedy said the decision to use a Florida agency wasn't motivated by AOF's past defaults in Texas, though it allowed him to avoid the need to win approval from the state's bond-review board.

"It's a very, very difficult process in Texas," he said. "They've had a lot of issues with 501c3 defaulted deals and so they just make you jump through a lot of hoops." Non-profit organizations are known as 501c3s, after the relevant section of the U.S. tax code.

Kennedy said he chose a Florida conduit because his original plan was to also buy an apartment complex in that state. That deal fell through, he said.

AOF was founded in Atlanta in 1983 to sponsor low-income housing. Kennedy became president in 1991. His compensation was about \$360,000 in 2014, according to tax filings. AOF owns or has ownership interests in 14,000 apartment units, which are managed by outside firms that it hires.

West Coast

AOF has been successful on the West Coast, where one of its subsidiaries, AOF/Pacific, serves as a general partner and has small ownership interests in more than 100 affordable properties with more than 13,000 units. Many are financed with low-income housing tax-credits so there's less leverage, Kennedy said.

AOF has also acquired, rehabbed and sold 125 single-family homes to first-time buyers.

"I'm not particularly proud of what I did in the 90s," Kennedy said. "I'm proud of the way I hung in there and got it all worked out."

Capital Trust Agency, the Florida conduit, has issued about \$1.9 billion of debt for projects such as private-jet facilities and hotels. To raise the money for AOF, Capital Trust charged about \$97,400 in fees.

Ed Gray, the executive director, said his agency reviewed financial statements and visited the apartment complexes in Plano and Fort Worth. About \$81 million of the debt Capital Trust has issued has defaulted, according to data compiled by Bloomberg.

"I can't speak to that," Gray said of AOF's default history. "I can only speak to projects that I'm aware of that they currently operate, and have found no lack of expertise."

Little Regulation

Public agencies like Capital Trust operate in a little-regulated corner of the municipal market. They issue bonds for private companies and nonprofit organizations that would otherwise lack access to tax-exempt borrowing. Local taxpayers benefit from the fees and aren't on the hook to repay the bonds, which are often used for riskier real-estate projects.

All 50 states have conduit issuers. Florida is one of seven that allow some conduits to issue debt for out-of-state projects, according to the Council of Development Finance Agencies. The practice has drawn criticism from some public officials, who say it can allow debt issuers to elude oversight by financing projects through authorities beyond their jurisdiction.

AOF's Plano and Fort Worth debt was good enough for Bank of America Corp. The bank bought \$26.1 million of the bonds, which yielded 5.5 percent. Fundamental Advisors, a New York-based private equity firm, bought another \$11 million of subordinate notes that pay interest as high as 15 percent. AOF provided \$600,000 in equity, according to Capital Trust. Melissa Kitlowski, a Bank of America spokeswoman, and Julie Oakes, a Fundamental spokeswoman, declined to comment.

Public Purpose

Gray of Capital Trust said AOF's housing complexes were in good shape and generate enough income to support the debt.

"We felt this financing for these properties was a good public purpose for us to be involved and therefore when the applicant came to us to consider issuing the bonds, we did so," Gray said.

Plano, whose median household income is 60 percent higher than the state's, has a population of 280,000 and is located about 20 miles (32.2 kilometers) northeast of Dallas. It's dotted with corporate campuses. In 2014, Toyota Motor Corp. decided to move its North American headquarters to Plano from California. Garden Gate, AOF's apartment complex, is the town's only subsidized low-income housing for families.

"All we've done is allowed them the ability to issue tax-exempt" debt, said Denise Tacke, Plano's finance director. "We have no responsibility for repayment."

Bloomberg Business

by Martin Z Braun

June 9, 2016 — 2:00 AM PDT Updated on June 9, 2016 — 7:24 AM PDT

[U.S. Municipal 30-year Bond Extends Record Low Yield for Third Day.](#)

The yield on AAA-rated 30-year U.S. municipal bonds fell for the third consecutive day to an all-time low of 2.27 percent on Thursday, according to Municipal Market Data's benchmark scale.

A surge in municipal bond issuance this week was met by strong demand from investors, many of them foreign buyers being drawn to the market in an attempt to escape negative interest rate policies abroad.

"Munis are the most attractive ugly duck left," said Greg Saulnier, municipal analyst for Municipal

Market Data. "Given what foreign money looks like, investors are snapping these up."

Investors this week saw a whopping \$12 billion of new sales enter the market, a high for the year to date.

Municipal market investors have also been encouraged by Federal Reserve Chair Janet Yellen's comments on Monday that rate hikes could be pushed off until later in the year.

The streak of record lows may not be over yet. July is typically the biggest month for principal and coupon redemptions, which will likely again boost demand for municipals.

Over the past two days, the market also saw record low yields on 30-year AAA-rated municipal bonds of 2.36 percent on Tuesday and 2.34 percent on Wednesday.

The yield on AAA-rated 10-year bonds ended Thursday at 1.56 percent, nine basis points above the all-time low of 1.47 percent set in November 2012.

Reuters

By Robin Respaut

Thu Jun 9, 2016 4:08pm EDT

(Reporting By Robin Respaut; Editing by Bill Trott and Dan Grebler)

[As Trump, Clinton Push Infrastructure, Muni Deals at 6-Year High.](#)

Donald Trump and Hillary Clinton don't share many positions. But the need to revamp the nation's infrastructure is one of them.

Clinton, the likely Democratic presidential nominee, says the U.S. is "dramatically underinvesting in our future," and she'd pour money into roads and waterways. Trump, the presumptive Republican candidate, is blunter: the country's infrastructure is "terrible" and airports are "a disgrace." He wants to "start the greatest long-term building project in American history."

It appears that local leaders are finally coming around to that line of thinking, seven years after the end of the recession. With interest rates the lowest since 1965, states and cities issued \$67.3 billion of debt for infrastructure in the five months through May, the most since 2010, Bank of America Merrill Lynch data show. That was the last year of the federal Build America Bonds program, which encouraged governments to borrow by paying a share of the interest bills on debt sold for public works.

While the uptick is still just a fraction of what's needed to shore up thousands of deficient bridges and countless pothole-laden roads, it reflects a long-awaited shift by municipal officials who have hesitated to borrow for new projects even with interest rates at five-decade lows. The increase coincides with unprecedented demand for tax-exempt debt, suppressing yields and saving states and cities millions of dollars.

"Recent history tells us that simply having low interest rates is not going to be what drives cities to take on new debt," said Christiana McFarland, director of research in Washington at the National League of Cities. "The looming threat of infrastructure needs is certainly putting cities in a position

to do everything they can to take on those projects now.”

The American Society of Civil Engineers estimates that the U.S. will fall \$1.44 trillion short of the \$3.32 trillion it needs to invest in infrastructure through 2025.

It's not just states and cities that are responsible for that gap. Congressional officials last year spent weeks haggling over a transportation-funding measure before finally enacting a five-year, \$305 billion bill that incrementally raises spending each year.

If presidential campaign promises are to be trusted, help could be on the way.

Clinton's website features a plan that would raise federal spending on public projects by \$275 billion over a five-year period, including a national infrastructure bank that would run an expanded Build America Bonds initiative.

In Trump's book, "Crippled America: How to Make America Great Again," he doesn't put an exact price tag on infrastructure spending, but calls it "a trillion-dollar rebuilding program" that'll be "one of the biggest projects this country has ever undertaken."

"Regardless of what happens at the state and local level, the federal government needs to be a strong partner in any solution," Brian Pallasch, managing director of infrastructure initiatives at American Society of Civil Engineers, said in an interview. "The presidential candidates, I'm heartened to see all of them in different ways at least mentioning infrastructure and saying it's important that we start dealing with it."

In the meantime, states and localities are stepping up borrowing for public works as their finances improve. Over the past year, they've boosted spending on public construction to the most since 2010, Census Bureau data show.

California, the most-indebted U.S. state, sold \$813 million of bonds in March for projects including clean water and clean air, children's hospitals, earthquake and highway safety, housing and emergency shelters, traffic reduction and port security, offering documents show. Across the country, Maryland borrowed about \$1.04 billion on Wednesday for construction projects, grants to localities and other initiatives.

Even with municipalities ramping up bond sales, it's unlikely the pickup will push interest rates higher, according to a report this week from Municipal Market Analytics.

That's because individuals have poured money into muni mutual funds every week since October, the longest streak since 2010, Lipper US Fund Flows data show. The more than \$16 billion of inflows to start the year is the most since at least 1992.

The yield on a Bond Buyer index of 20-year municipal general-obligation bonds plunged to 3.18 percent on Thursday, setting a new 51-year low. Top-rated 10-year munis yield 1.55 percent, according to data compiled by Bloomberg, while those due in three decades yield 2.36 percent, the lowest since the data began in 2009.

"You have budget surpluses in a number of states, and extremely low yields available in the market right now allow them to borrow at attractive rates," said R.J. Gallo, head of the municipal bond group at Federated Investors, which oversees \$6.9 billion of the debt. "It all adds up that you're seeing more new-money financing and more public construction. The muni market can certainly handle it."

by Brian Chappatta

June 10, 2016 — 2:00 AM PDT Updated on June 10, 2016 — 6:19 AM PDT

Despite Strong Muni Market, GO Munis Turn Risky: BlackRock

The muni bond market is now questioning the willingness and ability of some issuers to make payments on general obligation bonds: BlackRock's Peter Hayes

Municipal bonds, a favored fixed income asset class among high net worth investors, are experiencing strong demand this year despite the debt troubles of Puerto Rico, New Jersey and Illinois and gains that, unlike last year's, are lagging those of Treasuries and investment grade and high yield corporate bonds.

Flows into muni bond funds topped \$22 billion for the first five months of the year, and muni fund assets reached a record high of \$632 billion as of June 1, according to Lipper. Demand from foreign borrowers seeking higher yields is adding to demand. Year-to-date investment grade munis have returned just over 3%, capturing most of the gains that BlackRock's Municipal Bonds Group had been expecting for the full year.

Peter Hayes, a managing director and head of the group, said Wednesday the firm is now reassessing its outlook but expects another 1.5% return for the remainder of the year.

Despite the relatively strong performance of municipal bonds overall, however, he expects the problems of issuers like New Jersey and Illinois, which have large fixed costs for pensions but not enough revenues to pay them, will likely get worse, and general obligation bonds will suffer the most.

The GO category of muni bonds, backed by the full faith and credit of the issuer, have traditionally been considered the gold standard and safest type of issue among muni credits, but that view has been upended by the problems dating back at least to Detroit, said Hayes.

"The muni bond market is now questioning the willingness and ability to pay of some entities to pay," said Hayes. He doesn't expect that sentiment will abate anytime soon.

"Two things have to happen first," said Hayes. "You have to have significant pension reform and cut benefits or you've got to pay for it. Many of the entities have the ability to pay for it to some degree but politically they don't want to."

Those politics could potentially change in some states if elections result in one party rule of the governor's office and legislature, but in the meantime the muni market "will continue to question the GO structure," said Hayes. And spreads in such states, which also include Pennsylvania and Connecticut, could widen further.

About Illinois which recently announced plans to borrow \$550 million for capital projects, Hayes said the state should be penalized by muni market participants "in some way, by almost not giving them any access to the market....Think about it — they're a state without a budget, they refuse to pass a budget, they have the lowest funded ratio on their pension of any state, and yet they're going to

come to market and borrow money.”

ThinkAdvisor

By Bernice Napach
Senior Writer

JUNE 8, 2016

Surprise: Taxable Munis Beat Tax-Free this Year and Longer.

Municipal bonds that are taxable at the federal level are surprising outperformers this year. While tax-free munis were up 2.7% through the end of May, taxable munis were up 6.71%. That’s even better than high-yield munis, which were up 4.73% in that time frame, according to Eaton Vance.

It’s not just this year. The 5-year and 10-year returns of taxable munis are also higher than tax-exempt munis. Taxable munis gained an average of 8.1% a year over the last five years and 6% over the past 10 years. Tax-exempt munis gained 5.3% and 4.7% in those two time periods.

Most individual investors don’t know even know taxable munis exist. But institutional investors, looking for yield under every stone, are increasingly finding these securities attractive, says Adam Weigold, portfolio manager at Eaton Vance, who wrote a [blog post](#) Tuesday that explains the dynamics of the market.

One dynamic is that a lot of foreign investors are buying these bonds for their high yields and relative safety.

Weigold concludes his piece:

We believe a flexible opportunistic approach allows access to all parts of the muni market: Taxable or Tax Exempt. Taxable municipal bonds can round out a diversified fixed-income portfolio, offering competitive yields, high quality and low risks of default. As a result, taxable U.S. municipal bonds are bringing the potential rewards of investing in U.S. infrastructure and other public-purpose projects to a growing number of U.S. and non-U.S. investors alike.

Weigold manages Eaton Vance Municipal Opportunities (EMOAX), which has returns in the top 3% of all muni funds for the five-year, three-year and one-year periods, according to Morningstar.

Barron’s

By Amey Stone

June 7, 2016, 2:42 P.M. ET

Still Budget-Less Illinois Has U.S. Muni Market On Edge.

The possibility that Illinois could enter an unprecedented second straight fiscal year without a

budget had the U.S. municipal bond market worried on Wednesday over when the state might begin to make progress in addressing its financial woes.

The Democratic-controlled legislature wrapped up its spring session late on Tuesday without a fiscal 2017 spending plan or even a school funding budget that both the House and Senate could agree on. Democratic leaders, who are battling Republican Governor Bruce Rauner over his pro-business and labor-weakening reform agenda, also refused to immediately take up the governor's short-term budget plan.

Illinois has limped through 11 months of fiscal 2016 as the only U.S. state without a complete budget, operating under court-ordered spending, and continuing and stopgap appropriations. As of Wednesday, any budget legislation would need a more demanding three-fifths majority vote to pass.

"I don't see anyone blinking an eye unless the political pressure becomes so intense or the finances and credit rating of the state become even more dire," said Dan Heckman, senior fixed-income strategist at U.S. Bank Wealth Management.

Credit rating agencies have warned Illinois, which has the lowest bond ratings among the 50 states, of further downgrades if it fails to tackle a \$111 billion unfunded pension liability and huge structural budget deficit.

"Political paralysis is preventing the state from addressing its pressing financial challenges," said Ted Hampton, an analyst at Moody's Investors Service, which rates Illinois Baa1 with a negative outlook.

Richard Ciccarone, the head of Merritt Research Services, which analyzes municipal bond credits, said he expects the state's so-called credit spread to widen in the municipal bond market as a result of the continuing impasse.

On Wednesday, the spread for Illinois bonds due in 10 years remained steady at 175 basis points over Municipal Market Data's benchmark triple-A yield scale. By contrast, the spread for New Jersey, another state with fiscal problems, was 100 basis points, while California's was only 20 basis points.

"If (Illinois) made significant changes, the market would applaud with a little support," Ciccarone said.

The state appears to be bracing for credit rating cuts. The governor's budget office has hired consultants to help Illinois disentangle from interest rate swap agreements that could cost the state more than \$100 million should its ratings fall below specified levels.

REUTERS

CHICAGO, JUNE 1 | BY KAREN PIEROG

(Editing by Matthew Lewis)

[U.S. Municipal Debt Draws Rush of Investors.](#)

Cash has poured into muni-bond mutual funds this year, sending yields down to near-record lows

Investors are buying municipal debt at a record clip, enduring low returns in exchange for the relative stability of bonds sold by U.S. state and local governments.

Municipal-bond funds had more than \$632 billion in assets as of June 1, a record high, according to Lipper data going back to 1992. Investors have poured a net \$22.5 billion into such mutual funds in 2016 through Wednesday, the best start to a year since 2009. They have pulled \$39.97 billion from equity funds in the same time.

The buying is being spurred by ongoing concerns about the slow pace of global growth and the prospect of interest rates staying lower for longer, concerns boosted by Friday's weak jobs report.

In addition, low—or negative—yields on government bonds world-wide have made munis increasingly appealing relative to other fixed-income assets. The amount of municipal debt held by foreign investors increased 44% to \$85 billion from 2009 through 2015, according to Federal Reserve data.

Munis also provided a haven for investors during sharp swings this winter in the equity and high-yield corporate-bond markets. And years of price appreciation in munis have left investors hungry to snap up new issues.

Enthusiasm for the debt has driven prices in the roughly \$3.7 trillion market so high that yields have fallen to near-record lows. The enthusiasm comes even as Puerto Rico is defaulting and concerns persist about the financial health of some cities and states. In addition, U.S. interest rates are still expected to rise this year, which can hurt the value of outstanding bonds.

Investors prize munis in general because they are considered nearly as safe as Treasuries, backed by tax revenue or fees on critical public services, such as water. The debt also offers interest payments that are typically free from federal taxes. In the years since the financial crisis, the highest-rated municipal bonds have often yielded more than Treasury debt. But that trend has begun to reverse in recent months, intensifying some analysts' concerns about the risks of purchases at current prices.

Yields "aren't all that attractive anymore, yet we continue to see inflows into the funds," said James Kochan, chief fixed-income strategist at Wells Fargo Funds Management. "It doesn't take much to produce negative returns from these levels."

Yields on the Barclays Municipal Bond Index fell to a record low of 1.75% in mid-May and were at 1.83% on Friday.

Municipal bonds have returned 2.89% so far this year, counting price appreciation and interest payments, according to Barclays PLC as of Friday. That compares with 3.88% for Treasuries, 6.14% for highly rated corporate debt and 8.09% for junk bonds.

Rick Taormina, head of municipal strategies at JPM Asset Management, said some investors have been experiencing "rate shock," surprised by the low yields even on longer-dated or less-creditworthy debt.

Despite such low yields, the hazards of municipal bonds—including hundreds of millions in defaults from Puerto Rico—seem mild compared with the year's swings in stocks and other riskier assets.

The supply of new bonds has fallen, helping to drive up prices. Government borrowers have issued \$170 billion of bonds from the beginning of 2016 through June 1, down 4.2% from the same period of 2015, according to Thomson Reuters data.

“When there’s less volume, there’s more money chasing after fewer and fewer bonds,” said Howard Cure, director of municipal research at Evercore Wealth Management. “I think a lot of governments are still getting over how tight their finances were just a few years ago.”

For cities and states that do borrow, costs have fallen. Connecticut, which was recently downgraded to double-A-minus by two ratings firms amid concerns about the state’s budgetary flexibility, last month sold 10-year bonds yielding 2.33%, down from a yield of 2.75% on 10-year debt the state sold a year ago, notes Matt Fabian, partner at the research firm Municipal Market Analytics.

Despite the threat of higher interest rates, few are predicting a major pullback in munis this year. Analysts said that Puerto Rico’s defaults have had little impact on the broader market. And the tax break provided by municipal bonds helps offset the low yields the debt currently offers.

John Miller, co-head of fixed income at Nuveen Asset Management, which manages about \$113 billion in state and local debt, said the imbalance between demand for the debt and the supply of new bonds is likely to keep prices high in the short term, even if the Fed raised rates.

“There’s a bit less fear around the implications of that,” he said. “Even though munis are at low yields relative to history, they’re at high yields relative to the rest of the world.”

THE WALL STREET JOURNAL

By HEATHER GILLERS and AARON KURILOFF

June 5, 2016 2:24 p.m. ET

[GASB Project Update: Financial Reporting Model Reexamination.](#)

The GASB [added a project to its agenda](#) in September 2015 to reexamine the financial reporting model. The primary guidance that would be impacted by this project is Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, but also includes several other related pronouncements.

Issued in 1999, [Statement 34](#) set the formats and measurement focuses of financial statements that are in place today. The Statement ushered in important innovations to general purpose external financial reporting and made it possible for users to more fully assess a government’s overall financial health.

As the GASB continues to work toward an initial document for public comment in its reexamination of the financial reporting model, this article previews key issues the Board expects to address.

Initial Document Expected In 2016

The GASB anticipates issuing an Invitation to Comment before the end of 2016. The Invitation to Comment will seek feedback from stakeholders on certain aspects of the current financial reporting model.

Based on the feedback received during the initial pre-agenda research, the Board decided that rather than starting from a blank slate, the approach of the financial reporting model reexamination should be to make improvements to the existing model. The overall objective of this project is to

enhance the effectiveness of the model in providing information needed for making decisions and assessing a government's accountability—and to address application issues.

The Invitation to Comment will address improvements to various aspects of:

- Governmental fund financial statements, which have traditionally focused on the short-term finances of the most basic activities of a government, such as police, fire, sanitation, and
- Government-wide financial statements formats, which cover both the short- and long-run finances of all of a government's activities (except fiduciary activities).

Governmental Fund Financial Statements

GASB research has determined that governmental fund financial statements are not as effective as they could be in providing information that is essential for users to make decisions and for assessing a government's accountability. Research also has led the GASB to determine that opportunities for improvement exist.

For example, rather than being based on a cohesive conceptual foundation, the current financial resources measurement focus used for reporting governmental funds is an accumulation over many decades of common practices and conventions. (A measurement focus describes the types of resources that are reported in a financial statement.) Furthermore, this measurement focus has not been comprehensively reviewed in nearly 20 years. As a result, the information reported in financial statements prepared using this focus can be inconsistent and does not necessarily provide users what they need.

Another issue the Invitation to Comment is expected to address includes how the format of governmental fund financial statements might be revised to improve their utility and understandability.

Government-Wide Financial Statements

[Recent Video on the Model](#)

The Invitation to Comment also is expected to address the format of the government-wide statement of activities. The statement of activities reports a government's revenues and expenses, as well as other changes in the government's net position. GASB research has indicated that some users find this financial statement to be somewhat confusing and not as helpful as it might be for making decisions.

Looking Ahead

The project is expected to unfold over a relatively long time horizon, which could mean the reexamination would extend into 2021.

We welcome your input once the Invitation to Comment has been issued. Sharing your views with the Board will be a key element of a successful outcome in this project.

[Register](#) to attend the June 21 Task Force meeting in New York.

Read a recent [GASB Outlook article](#) on the financial reporting model reexamination.

GFOA: The Perils of “Benefit Bonds” and Social Impact Bonds.

At “Just Say No: Financial Products and Strategies to Avoid,” a Tuesday session at GFOA’s annual conference, the panelists discussed the pitfalls of newer, more “innovative” financial instruments that local governments have access to.

Pension and OPEB obligation bonds were discussed first. The prospective benefit of these “benefit bonds” is that the investment income that the government earns on the bond proceeds would exceed the interest paid out to the bond buyers. Gaining this benefit requires the government issuer to correctly time the market so that the time period of the borrowing takes place during a time period in the economy when the returns on investments exceed cost of borrowing—something that is easier said than done. Further, benefit bonds can even lead to poor decision-making about future benefit levels. This is because the bonds cause the government’s benefit liability funding ratio to appear to be improved – the bond proceeds are used to fund the liability. However, this doesn’t take into account the offsetting liability of the need to repay the bonds. Hence, this illusory improvement might offer improved benefits to plan participants.

For more information, see GFOA’s advisories:

- [Other Postemployment Benefits \(OPEB\) Bonds](#)
- [Pension Obligation Bonds](#)

Social impact bonds are another financial instrument we’ve been hearing about. Most of them follow a basic formula – private investors pay a government to launch a new social program that’s designed to achieve a measurable result. If the program works, funders get their money back, and some or all of the savings attributable to that result. If it fails, the funders lose most or all of their investment. Most social impact bond programs are usually delivered by non-profits that want to try innovative approaches to solving social problems. If the program works, the participant that fronted the money (usually an investment bank) gets investment back plus a return, which comes from cost savings (from small case studies, less expensive cases, and so on). If the project fails, the investor loses its investment.

These investments are incredibly complex, multi-year undertakings, and the first thing a local government considering one needs to determine is whether it can commit to putting a lot of resources into managing the project for a long time. Sophisticated, solid program evaluation is required throughout the program.

The main advantages to social impact bonds are:

- There’s a lot to be said for focusing on impact, not outputs or throughputs (despite the difficulty).
- These projects are often about applying a little prevention (to, say, decrease homelessness), and a little prevention goes a long way.
- This can provide an opportunity to “backfill” federal and state funding that had been lost after the recession.
- Evidence-based policy is generally a good idea for new service delivery models.

The main concerns, and they are significant, are:

- It’s difficult to measure impact. How is it defined? How do we get the data to measure it? How do you isolate the program’s effect on second graders’ reading? Even the most sophisticated measures can’t single this sort of information out.

- Does “pay for success” imply that what we’ve been doing up until now is paying for failure? Some would say yes, but in many cases, this is not the case, and it does a disservice to the many government projects being run well and producing excellent results.
- What are “cost savings”? Is reducing marginal costs alone a compelling reason for social impact bonds?
- There’s upside risk. If a social impact bonds reduce costs more than expected, is there gain sharing for governments? Some programs have been wildly successfully, and the last thing you want to see is a headline that says “Goldman Sachs profits wildly from investment in City X.”
- Are social impact bonds sustainable without the role of philanthropy?

Why should finance professionals care? Because it’s going to start coming up more and more often. The idea has great headline appeal – no elected officials will want to avoid an opportunity to “leverage private sector and philanthropic investment to transform the lives of children.” Any finance officer approached about a social impact bond deal should do a thorough feasibility analysis.

Government Finance Officers of America

Tuesday, May 24, 2016

[Land Use Policy: Do the Math!](#)

Have you considered how you can use data to look at your city in a different way – to find out what it’s really worth? In his Monday conference presentation, “The Financial Impacts of Land Use Policy,” Joe Minicozzi, principle of Urban3, a consulting firm created by a real estate developer, discussed the importance of data modeling to determine your real potential for increasing tax revenues. His advice is, in short, “Do the math!”

The traditional development model favors big box retail – which does present a substantial tax payoff. But studying all the data can create a different picture. In other words, you have to measure everything to know what you really have.

Minicozzi told the audience to “divide the land into the value.” His research shows an exponential jump in the amount of county property tax received from one- to two-floor residential, and an even bigger jump from two- to three-floor residential. Adding in street-level retail makes the increase even greater. Adding the parcels of land a big-box store would require and comparing the numbers to expected tax returns from the retail development shows that overall, the smaller parcels lead to greater potential tax returns.

Minicozzi noted that this analysis often seems overly simplistic, but he added that simple doesn’t necessarily equate to wrong. After all, he pointed out, “We put a man on the moon before we put wheels on luggage.”

Finance officers can provide the information that makes this kind of analysis possible. Minicozzi noted that when we look at real estate, we tend to look at total value, which isn’t necessarily the best way to understand land use. Taxable value per acre is a better measure. He suggested ditching the spreadsheet and using modeling technology to demonstrate the true value of property.

Take a look at Minicozzi’s [conference session slides](#), which show a number of interesting modeling possibilities.

Learn more about using modeling to affect land use policy in Minicozzi's August 2013 article for Government Finance Review, ["Thinking Differently about Development."](#)

Further information is available from GFOA's best practice, [Monitoring Economic Development Performance](#).

Government Finance Officers of America

Monday, May 23, 2016

[NAST & SDMN Webinar: Transportation Funding Options.](#)

This webinar covers various transportation financing options and tools available to states including Bonds, GARVEEs, P3s, Managed Lane Programs and TIFIA Loans as well as a brief overview of the U.S. Department of Transportation's Build America Transportation Investment Center (BATIC).

[Watch the Webinar.](#)

State Debt Management Network

5/18/16

[Municipal Bond Issuance Up Slightly in May.](#)

Sales of U.S. municipal bonds ticked up slightly in May, with more new sales and refunding deals coming to market than during the first four months of the year, according to Thomson Reuters data.

Total sales in May were \$39.4 billion, 17 percent higher than in April, and 16 percent higher than in May 2015.

Overall, calendar year 2016 has thus far resulted in slightly less sales than the same period last year – there has been \$168.6 billion of municipal issuance during the first five months of 2016 compared to \$177.8 billion in the same period last year – in part due to fewer refunding deals.

Issuers sold \$104.3 billion of refunding bonds in 2,653 deals during the first five months of 2016, compared to the \$124.1 billion of refunding bonds sold during the same period in 2015 across 3,157 deals, the data shows.

The market saw a rise in new debt sales as issuers sold \$16.6 billion in new bonds across 617 deals in May, compared to \$13.2 billion over 652 deals in May 2015. Overall, new money deals rose in the first five months of 2016, with \$64.4 billion compared to the same period in 2015 with \$53.7 billion of new sales.

Municipal investors should prepare for a busy month in June, typically a time of year that experiences higher gross supply before the lethargic summer months, Morgan Stanley reported this month, although market participants should "keep some 'powder dry' due to the possibility of rising interest rates" later in the year.

Reuters

May 31, 2016

(Reporting by Robin Respaut; Editing by James Dalglish)

P3 Bills In Play In Two States.

The Massachusetts and Pennsylvania legislatures are considering bills that would authorize the development of certain infrastructure projects through public-private partnerships.

The Massachusetts bill (S. 1722), sponsored by Senate Minority Leader Bruce Tarr, would allow municipalities to enter into P3s to develop, finance, operate and maintain municipal water, wastewater and stormwater infrastructure projects for up to 30 years. The developer would be authorized to charge fees or negotiate service contracts for its services. The public agency that negotiates the P3 would be required to provide a copy of the preferred proposal to each affected local jurisdiction and to consider all comments received before signing an agreement. The bill has been referred to the Senate Ways and Means Committee.

The bill is supported by a coalition of associations and industry groups including the Massachusetts Municipal Association, the Massachusetts Municipal Lawyers Association, the American Council of Engineering Companies of Massachusetts, the Boston Society of Civil Engineers/ASCE and the National Association of Industrial and Office Properties.

Matthew Feher, an attorney with the law firm Burns & Levinson, LLP, and a staunch proponent of the bill since it was introduced in January 2015, will be a featured speaker at NCPPP's annual conference, P3Connect 2016, June 27-29 in Chicago.

In Pennsylvania, Rep. Eli Evankovich introduced a bill that would launch a P3 pilot program to build up to 12 social infrastructure projects and establish a state P3 oversight board. The legislation (HB 2113) would authorize the use of P3s to develop water, wastewater and stormwater projects, schools and related infrastructure, government buildings, telecommunications infrastructure, and utility projects. To be eligible, all projects must be valued at \$25 million or more and no more than two could be conducted in each of six regions. State agencies and local governments would be permitted to consider unsolicited proposals. The pilot program would end once the last P3 agreement negotiated under it has expired. The bill has been referred to the House Committee on State Government.

Massachusetts and Pennsylvania are the latest states to consider P3 legislation to meet their infrastructure needs. Kentucky and Tennessee recently enacted P3-enabling legislation. For a full list of state P3 laws and regulations, visit the Resources section of the NCPPP website.

NCPPP

June 2, 2016

S&P's Public Finance Podcast (Request for Comment on Charter Schools and Pensions)

In this week's edition, Avani Parikh, Associate Director, and Sussan Corson, Director, discuss the requests for comments for proposed changes to rating criteria for charter schools and pensions funded by states.

[Listen to the podcast.](#)

May 31, 2016

S&P Request for Comment: Proposed Changes to State Government Ratings Criteria.

In this CreditMatters TV segment, Gabriel Petek, Managing Director of U.S. Public Finance, and Sussan Corson, Director of U.S. Public Finance Ratings, discuss our new report outlining our request for comment on proposed changes to the ratings criteria for U.S. state and territory governments.

[Watch the video.](#)

May 31, 2016

Why We Should Put CFOs in the Infrastructure Driver's Seat.

As stewards of public spending, they are best positioned to help us invest effectively

We all know the story, or at least we think we do: The U.S. infrastructure machine is sputtering, and politicians are failing to fill up the tank with funding. But look under the hood and you will see that America's infrastructure engine needs more than just gas. It needs a total engine overhaul and a new chief mechanic: Government's chief financial officers (CFOs) need to be put in charge.

For years, we have let individual government agencies — separate departments of highways, water resources, energy and so on — drive independently while advocating for their favorite infrastructure projects. Procurement systems have favored low-cost capital bids, ignoring the long-term maintenance requirements of assets meant to last a longer lifetime. Most politicians have done little to address the unsexy challenge of deferred maintenance. Why repair a leak or two underground when one can get more press for cutting ribbon on a new project?

Sadly, this kind of thinking — where prevention is undervalued — is why we have public health disasters like Flint's, a broken-down Washington, D.C., regional subway system and our current \$3 trillion-plus deferred maintenance bill.

Yet the news is not all bad. There are new efforts emerging nationally and internationally led by CFOs, state treasurers and ministers of finance. The key concept is "performance-based infrastructure," which encourages governments to consider life-cycle asset performance rather than simply taking the low-cost bids and ignoring maintenance costs of assets that are meant to last 30 or

50 years.

This shift in thinking has been led by Canada and New Zealand, where individual agencies sponsoring infrastructure projects must first undertake an “independent infrastructure project assessment.” This requires agencies to consider more efficient ways to design, finance, procure and maintain the asset and to determine how best to manage important project risks, such as the effects of climate change.

Results are encouraging. There has been a \$110 billion infrastructure-project explosion in Canada in the last decade. This has led to more on-time and on-budget performance and created a new pipeline of financially viable public-private partnerships.

How would this work in the United States?

First, put local and state CFOs in charge of how we can better spend \$500 billion annually, especially since 75 percent of infrastructure spending happens at the local level. As stewards of public spending and impartial “owner-advisers” to public agencies, CFOs are best positioned to assess life-cycle risks, reform procurement systems, promote cross-agency integration and identify viable repayment mechanisms to attract private investment. (Want to nerd out even more on how to make this work? Check out the Government Accountability Standards Board’s Statement 34 for [how CFOs can implement life-cycle accounting](#) and [New York State’s Smart Growth Public Infrastructure Policy Act](#), which requires resiliency and climate risk analyses to be considered with each infrastructure investment.)

Second, build a new network of local, state and regional centers of expertise to shift the system from the bottom up. Only now is Canada creating a national center after a decade of local testing and proven success in British Columbia, Ontario and seven other provinces. The U.S. is also poised to drive this shift through the regional and metro accelerators scattered across the country, from the West Coast Infrastructure Exchange to accelerators now forming in the Washington, D.C., Northeastern and Intermountain regions.

Third, use “big data” to build infrastructure for the 21st century. The private sector is already doing this. Let’s take climate change. Major insurance companies like Swiss Re are busy looking at ways to monetize avoided storm damages by establishing incentives for resiliency investments before the next Superstorm Sandy happens. Insurers and investors need big data to accurately assess climate change effects. New project-design tools and performance-based infrastructure and data innovation techniques could shave 40 percent off of a projected \$57 trillion global infrastructure bill by 2040, according to a McKinsey Global report.

How can the federal government help promote this local and state shift? Support the bipartisan bill passed by Congress last December that calls for funding of more regional centers of expertise to accelerate local public-sector capacity. Another low-cost, high-impact congressional move? Why not allow innovative states and cities to tap into a new “federal flex fund” for the startup and design costs of innovative projects that don’t fit into current funding schemes designed during the Eisenhower era.

We will need more. Universities, business schools and technology companies should team up to train the next generation of infrastructure innovators. A new world of smart grids, driverless cars and broadband technology needs to get built, but first we need government CFOs to fire up their spreadsheets.

GOVERNING.COM

Government's Role in Helping Americans Save for Retirement.

As states begin stepping in to fill a void left by private employers, there are management challenges to keep in mind.

Most governments provide their employees with some form of retirement savings, but that's a benefit that has been fading away for decades in the private-sector workplace. Today, only 58 percent of full-time private-sector American workers have access to a workplace retirement plan and 49 percent participate in one, according to a recent report from The Pew Charitable Trusts.

This leaves more than 30 million full-time, full-year workers between the ages of 18 and 64 without access to an employer-based retirement plan. With so many private-sector workers worrying that even with Social Security they won't have enough money for retirement, it's not surprising that many states and the federal government are looking at ways to step into the void left by employers. The aim is not only to increase retirement savings but also to reduce poverty and the need for social assistance — spending that strains state budgets.

It's a complex challenge. Access to employer-based retirement plans varies widely. In Wisconsin, for example, 70 percent of full-time workers are able to take advantage of an employer-based plan, compared with just 46 percent in Florida. Gaps in the availability of retirement plans are even wider among the nation's metropolitan areas, according to research by Pew. In Grand Rapids, Mich., for instance, 71 percent of workers had access to a plan, compared with 23 percent in McAllen, Texas.

Access and participation also vary based on employer size, industry type, income, age and education — with some of the largest differences by race and ethnicity. Hispanic workers are almost 25 percent less likely to work for an employer that offers retirement benefits than are white non-Hispanic workers. Black and Asian-American workers also report lower rates of access than white workers.

While Congress and the Obama administration have proposed new ways to increase retirement savings, no major federal legislation has passed on this issue since 2006. As a result, state policymakers and agency heads have been looking at opportunities to fill the gap using tools that range from offering no-cost individual retirement savings accounts to providing tax breaks for contributions or for setting up a plan. The goal is to give employees an incentive — and the ability — to contribute on a regular basis directly from their paychecks.

Lawmakers in more than half of the states have introduced legislation to create or study state-sponsored retirement savings plans for employees who lack access at work. Illinois, Massachusetts, New Jersey, Oregon and Washington state already have moved forward with programs using a variety of approaches. But as state policymakers explore new programs to encourage workers to secure their own financial futures, they need to consider whether they have the administrative and financial capacity to manage a large retirement savings program.

Many states already run retirement plans for public employees, health-insurance exchanges and college savings plans. But creating viable state-run retirement programs for private-sector workers can present unique challenges — in particular, the ability to efficiently manage a large number of small account balances from numerous employers using a wide variety of payroll systems. Additionally, states must consider their responsibility to ensure the integrity of funds and

investments, meet reporting and disclosure responsibilities, and provide transparency and accountability.

Although state agencies have considerable financial and policy expertise about public pensions, there is much they can learn from the business community about private-sector retirement plans. A wide array of payroll providers, record keepers, investment professionals, financial educators, software developers and other service providers make up a retirement savings industry with over \$5 trillion in assets. States should reach out to these experts to better understand how to successfully manage the administration, outreach and cost-control challenges of a large retirement savings system.

States also can learn from the experiences of one another as they consider the best paths forward, and they would be well served to make policy choices that balance the competing objectives of employee retirement security, employer cost and administrative burdens, and risks for the state. They also need to take into consideration the specific economic and demographic characteristics of the workers who could participate. If states weigh these factors carefully, it may be possible to make a meaningful improvement in the retirement security of many working Americans while minimizing costs and risks to taxpayers.

GOVERNING.COM

BY SUSAN K. URAHN | JUNE 1, 2016

[Securing Retirement for All.](#)

Connecticut this week [joined the list of states](#) that are creating retirement programs for workers who don't have access to one through their employers.

The new law affects nearly 600,000 private-sector workers. Many of those workers can now be auto-enrolled into retirement plans that are privately managed but overseen by the state.

At least half the states are now exploring or implementing programs to provide retirement savings options for private-sector workers without access to a plan, according to a [report](#) released this week by The Pew Charitable Trusts. The states that have already enacted such a plan are Illinois, Massachusetts, New Jersey, Oregon and Washington.

The Takeaway: Most Americans are ill-prepared for retirement. More than 38 million people, or roughly 45 percent of working-age households, have no retirement savings at all, according to data from the National Institute on Retirement Security. More and more states — rightly recognizing that they'll foot the bill for a poor retiree's social service needs — are beginning to do something about this.

GOVERNING.COM

BY LIZ FARMER | JUNE 3, 2016

Bad Credit News.

While the overall number of government entities that defaulted on their debt in the past couple of years has remained virtually unchanged (hovering around 50), those rated by Moody's Investors Service have seen an uptick in defaults — from zero in 2014 to four in 2015.

According to a new Moody's report, the four defaults in 2015 were Single Family Mortgage Revenue Bond in Cook County, Ill.; Dowling College (which closed its doors Friday) in Long Island, N.Y.; Puerto Rico Public Finance Corporation; and Cardinal Local School District in Ohio.

In addition, the total percentage of credits that Moody's rates at junk status has doubled over the past five years — from 0.4 percent to 0.8 percent. The rate of junk bonds, however, has significantly decreased from 2014, when 1.6 percent of credits were rated below investment grade by Moody's.

The Takeaway: Municipalities are facing big budget constraints driven by higher expenses and revenue growth that can't keep up. That difficult combination has contributed to an increase in struggling municipalities, and there's no sign these long-term forces pressuring the public sector will abate, said Moody's Senior Vice President Al Medioli.

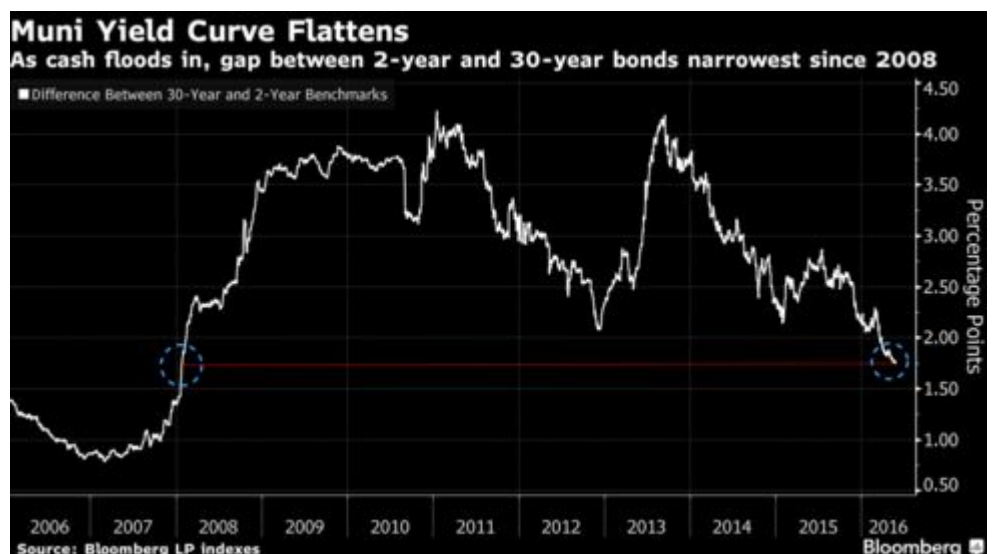
Moody's is not alone in this warning. Last month, one analyst said that a significant portion of municipal issuers are worse off than they were at the end of the Great Recession — a fact he blames on governments' inability to balance their revenue and spending.

Still, Medioli said, one positive story is that most municipal governments reacted to the recession by making significant budget adjustments. As a result, "Tax bases and fund balance reserves have broadly recovered to pre-recession levels," he said, "and in some cases strongly so."

GOVERNING.COM

BY LIZ FARMER | JUNE 3, 2016

Muni-Bond Yield Curve flattest Since 2008 Credit Crisis: Chart



The difference between short- and long-term yields in the \$3.7 trillion municipal-bond market is the

smallest in more than eight years. With tax-exempt mutual funds flush with cash from the longest stretch of inflows in six years, managers have poured money into higher-yielding securities, pushing up the price. By the end of last week, that left 30-year yields just 1.75 percentage points more than those on 2-year securities, the smallest since January 2008, when the credit-market crisis was building. That difference, known as the yield curve, shows that investors are receiving little compensation for the risk of owning securities that don't mature for decades.

Bloomberg Business

by William Selway

May 31, 2016 — 8:39 AM PD

[Muni-Bond Yields Creep Higher in Longest Streak in a Year: Chart](#)

The yield on a Bloomberg index of 10-year AAA rated municipal bonds has increased for seven straight trading sessions, the longest streak in nearly a year. The climb to about 1.63 percent from the lowest level since December 2012 began May 18, after minutes from the Federal Reserve's last meeting revealed that the central bank may be getting closer to another interest-rate increase in the coming months. The trend may not last, because muni mutual funds are flush with cash — they added another \$950 million in assets in the week through Wednesday, extending the longest stretch of inflows in six years, Lipper US Fund Flows data show.



Bloomberg Business

by Brian Chappatta

May 27, 2016 — 6:39 AM PDT

Buy The Dip Becomes The Muni Mantra as Bonds Become Even Scarcer.

The “buy the dip” mentality has come to the municipal market.

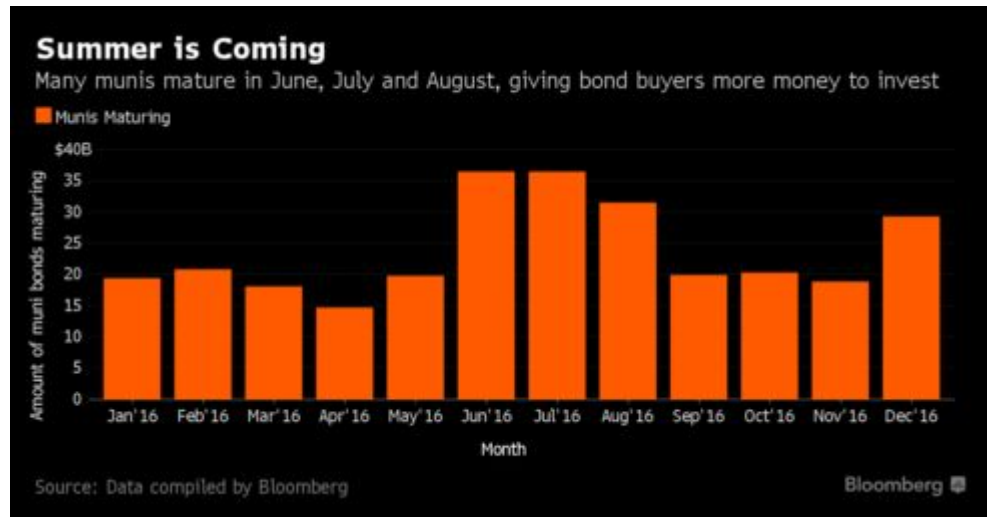
With tax-exempt yields at the lowest in five decades and mutual funds receiving the most cash since 2010, investors are looking at any pullback as a chance to buy. That’s just what they’ve got: Benchmark 10-year yields climbed by about 0.06 percentage point in the past week since minutes from the Federal Reserve’s last meeting suggested that the central bank may be getting closer to another interest rate increase in the coming months.

“Any backup, we’d view as a buying opportunity,” said Sean Carney, head of muni strategy at BlackRock Inc., which oversees \$119 billion of state and local debt. “As long as demand remains as strong as it has been, it’s difficult to identify the catalyst that breaks the back of recent market performance.”



The increase probably won’t last long, even if the Fed raises short-term lending rates. On top of the billions of dollars pouring into muni mutual funds, about \$73 billion of state and local debt will mature in June and July combined, the most this year, data compiled by Bloomberg show. That adds buying pressure at a time when tax-free yields are historically low, yet cheap relative to global alternatives.

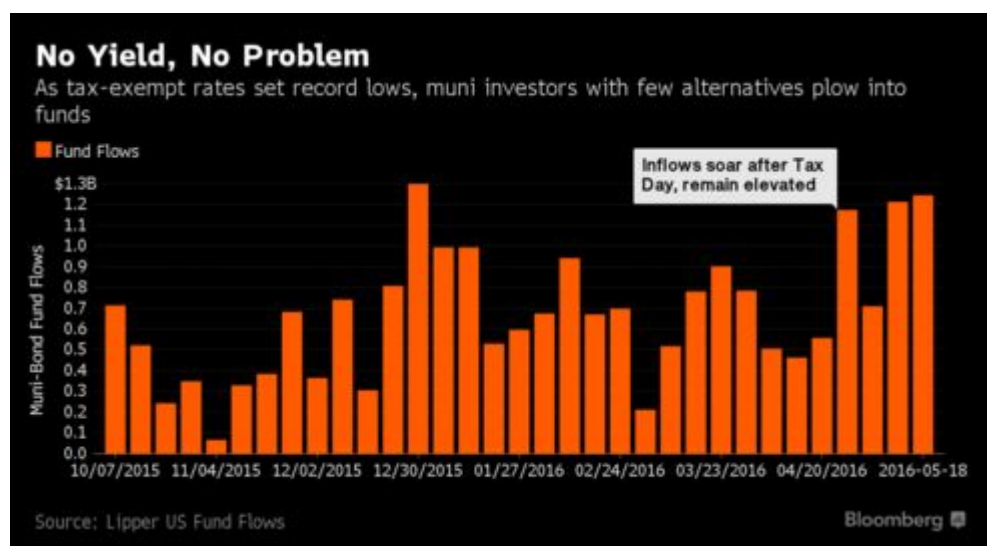
The \$3.7 trillion municipal-bond market has gained in each of the first four months this year, only the third time that’s happened since 1989, Bank of America Merrill Lynch data show. It’s up 0.4 percent in May, even as Treasuries and corporate debt have declined.



Even the tax-exempt market has weakened on the Fed officials' emphasis that they could raise their benchmark rate in June. The futures market is factoring in a 32 percent chance the U.S. central bank will raise rates next month, up from just 4 percent a week ago. Over that period, munis declined 0.2 percent.

Countering the effect of the Fed's minutes: Individuals poured \$1.25 billion into tax-exempt mutual funds in the week through May 18, the most this year, Lipper US Fund Flows data show. That extends the current streak of inflows to 33 weeks, the longest in six years.

In addition to the inflows, muni investors are poised to receive a wave of cash as their securities mature. About \$36.5 billion will come due in each of the next two months, and another \$31.5 billion will mature in August, data compiled by Bloomberg show. Many individuals hold the bonds until maturity for the tax-free income, meaning they'll use much of the principal payments to purchase new securities.



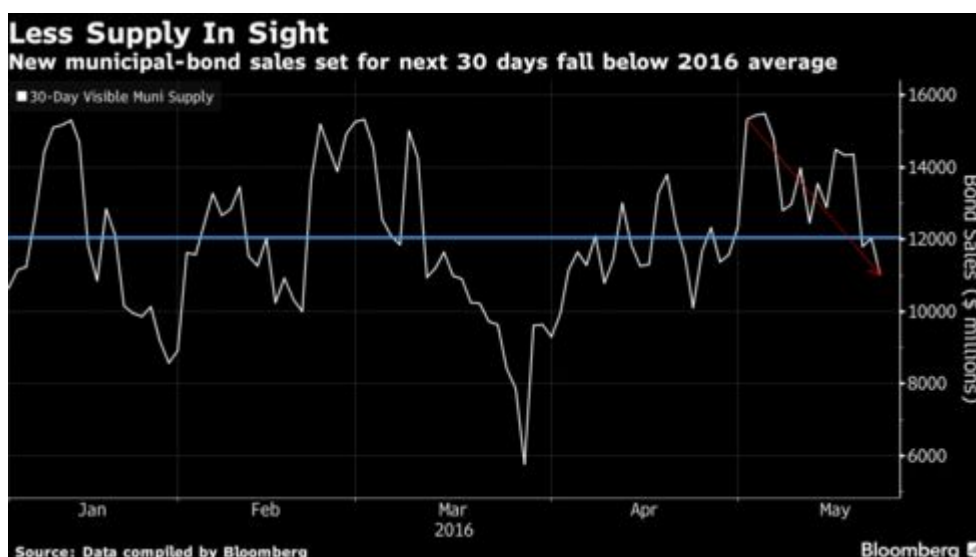
Others are newcomers — Asian and European investors who are buying U.S. state and local-government debt in the face of negative interest rates in their own countries.

"There's just been such rabid demand for munis this year," said Steve McLaughlin, a senior muni

portfolio manager focused on arbitrage trading at First Empire Securities in Chatham, New Jersey. When it comes to bond prices, “we’re at all-time highs, but we could shoot through that,” he said.

More investors are coming into the market looking for bonds just as fewer municipal issuers are selling them.

State and local governments have scheduled about \$11 billion of bond sales in the next 30 days, the smallest slate in a month, Bloomberg data show. While the figure tends to underestimate the amount of offerings because some are announced just days in advance, it serves as an indicator of what to expect.



Issuance tends to climb from May to June, explaining why munis have posted negative returns during the month in most of the past decade, BlackRock’s Carney said. The fact that the Fed is considering raising interest rates adds to the chance of losses in the weeks ahead, he said.

Though for any sellers out there, it appears there will be just as many buyers — if not more.

“These yields are low, but they certainly have the potential to go even lower as we head into June and July with a heavy calendar of maturing bonds and coupons,” said Phil Fischer, head of municipal research in New York at Bank of America Merrill Lynch. “Performance in munis has just been something to write home about.”

Bloomberg Business

by Brian Chappatta

May 24, 2016 — 2:00 AM PDT Updated on May 24, 2016 — 6:19 AM PDT

[How Zika Could Infect the Municipal Bond Market.](#)

Even if an area has no cases of the virus, it could feel a financial impact.

When you walk through Atlanta’s Hartsfield-Jackson International Airport, it’s hard to ignore the

solemn warnings that the city could be an entry point for the Zika virus into the United States.

Everywhere, large signs picturing a menacing mosquito warn travelers: “Don’t let this bad bug bite you.” Other signs warn pregnant travelers about a Zika health advisory. Last month, airport concessionaires began selling insect repellent with the recommended level of DEET to keep mosquitoes at bay.

But there are also financial implications of Atlanta’s status as a gateway to Central and South American travel, and for other cities like it. According to a [new report](#) by the investment firm, Loop Capital Markets, the Zika virus could make it more expensive for some municipalities to borrow money.

That’s because similar to natural disasters, a virus outbreak has the potential to overwhelm local and state health departments. Since Hurricane Katrina “demonstrated the enormous capacity of governments to botch disaster relief efforts,” Chris Mier, the report’s author, says previous research has shown that a region’s susceptibility to disasters plays a role in their municipal interest rates. For example, a study of California’s more earthquake-prone cities found that they paid a higher interest rate on their bonds following Hurricane Katrina.

That means the same consequences can apply to other disaster situations, including a Zika epidemic. Making matters worse now is the fact that public health resources have become more constrained, so states and localities could be limited in their ability to quickly contain the virus.

“While no one knows the extent of health problems Zika may cause in the U.S., the federal and state response may be underwhelming, resulting in greater health and economic damage than previously expected,” wrote Mier.

Meanwhile, Congress has yet to agree on funding to fight the virus, despite warnings from health officials about the need to move quickly. The Senate has passed a bill freeing up \$1.1 billion in funding, far less than the White House’s original request of \$1.9 billion. The House of Representatives, however, only wants to provide \$622 million.

So far, more than 1,500 cases have been reported in the U.S. and its territories. All 591 U.S. infections were acquired from travel, which means there’s no proof yet that mosquitoes carrying the virus have made it to the states. But in the U.S. territories, all located in the Caribbean, all but four of the 939 cases were contracted locally.

U.S. cities most at risk for the Zika virus are primarily in the South but extend as far north as New York City and as far west as California’s Central Valley. In particular, Mier says Zika may pose a greater financial risk to nine states that have fallen below the national average in public health expenditures: Arizona, Florida, Georgia, Louisiana, Mississippi, North Carolina, Pennsylvania, South Carolina and Texas.

“Any credit-related impact should likely emerge in these states first,” said Mier, noting that they’re more likely to see interest rates increase than credit ratings downgraded.

Even without an outbreak in the U.S., Mier’s report said the Zika virus could still have a negative financial impact. At-risk cities that rely on tourism could see economic activity slow if public health concerns fester. Florida and New York, where one-third of the U.S. cases have been reported, are most vulnerable. In particular, New York City, Orlando and Tampa have emerged as popular landing places for Puerto Rico residents looking to escape the economic recession on that island.

Carried by mosquitoes, the Zika virus started spreading extensively in the Caribbean, South and

Central America last year. Prior to 2015, Zika had been found in parts of Africa, Southeast Asia and the Pacific Islands. The virus is thought to be mild, although it has been linked to serious birth defects such as microcephaly (shrunken head and brain) if contracted while pregnant.

GOVERNING.COM

BY LIZ FARMER | MAY 27, 2016

Some Investors Begin to Cool to Hottest U.S. Muni Bonds.

May 26 For more than eight months, investors have poured money into the riskiest U.S. municipal bonds, boosting prices as they dive into anything that can give them fatter yields in a global low-rate environment.

But increasingly, some portfolio managers and analysts are raising concerns about high-yield muni. They are waving red flags about its most notorious borrower, Puerto Rico, but also its best-performing sector, tobacco, and other potentially troublesome areas.

The space should be navigated with “extreme caution,” said Citigroup muni strategist Jack Muller.

The sector has ring fenced its most troubled issuers, and investors could be penalized if they get stuck holding bonds that slip into that roped-off territory.

At the start of last year, market sentiment priced about \$74 billion of munis in that distressed category, based on Citi’s analysis. By this January, the figure doubled to about \$150 billion, Muller said.

“You don’t want to be part of anything when it does make that transition into the market consensus of distressed,” Muller said.

Money has flowed to high-yield muni funds for 33 straight weeks, with nearly \$5 billion of inflows so far this year alone. It was the best first quarter for high-yield fund flows in nine years, according to data from Lipper, a Thomson Reuters unit.

Investors are chasing returns. The S&P Municipal Bond High Yield Index has notched 4.02 percent of positive returns this year. Within the sector, a strong performance from tobacco bonds, with returns of 9.05 percent, has offset Puerto Rico’s weaker 0.95 percent returns, according to S&P indices.

The outperformance could mask potential landmines. Chicago’s Board of Education, for example, sold 28-year bonds in February at about 84 cents on the dollar. The same bonds are now trading above par at 101.5 cents, even though the school district’s many challenges remain undiminished.

“The high-yield muni market to me seems to be flashing a caution sign. There’s not a lot of great value and opportunity there,” said Chad Farrington, manager of Columbia Threadneedle’s high-yield municipal fund.

Columbia raised the fund’s credit quality while increasing cash and other highly liquid assets to 20 percent of the portfolio, the highest since Farrington began managing the fund seven years ago.

To Nicholas Venditti, a Thornburg Investment Management portfolio manager, Puerto Rico and

tobacco bonds are both “garbage.”

The two categories make up 60 percent of the Bank of America Merrill Lynch Municipal High Yield Index.

To buy such bonds now would be “literally buying the weakest credit at the most expensive it’s ever been in history,” Venditti said at a recent media event. He said extremely tight credit spreads meant that investors are not getting enough extra yield for buying riskier bonds.

Only about 3 percent of Thornburg’s Strategic Municipal Income Fund is currently in junk bonds.

For tobacco in particular, the “very, very large outperformance that they’ve had is going to be hard to repeat,” said John Miller, co-head of fixed income for Nuveen Asset Management.

The bonds are sold by state and local governments and backed by money from U.S. tobacco companies under a 1998 legal settlement. The risks on these bonds are known, and most expect them to begin defaulting in several years.

Fitch Ratings said last week it would soon strip its ratings from tobacco bonds. Prices on some tobacco bonds were little changed following Fitch’s announcement.

REUTERS

NEW YORK | BY HILARY RUSS

(Additional reporting by Robin Respaut in San Francisco and Karen Pierog in Chicago; Editing by Daniel Bases and Bernadette Baum)

San Francisco Issues World’s First Climate Certified Water Bond.

The San Francisco Public Utilities Commission (SFPUC) has become the first organisation to issue a green bond certified under the Climate Bonds Water Criteria. The certified bond was issued for US\$240 million with tenors ranging from 7-30 years and coupons of 4 and 5 percent.

“Having a large US municipal authority seeking certification against the Climate Bonds Standard is a positive signal to the US municipal market on the benefits of certifying against the Standard,” Justine Leigh-Bell, Head of Standards Programme at the Climate Bonds Initiative who developed the Criteria, told Cities Today. “Particularly a leading authority like SFPUC which acknowledges the risks of climate impacts and the need to incorporate adaptation and resiliency factors that must be addressed as part of sustainability in water policy, future water infrastructure design and practice for water usage.”

The San Francisco Public Utilities Commission is the third largest municipal utility in California. Proceeds from the US\$240 million Waste Water Revenue Bonds will fund eligible sustainable storm water management and wastewater projects from Phase 1 of the utility’s Sewer System Improvement Program.

The Sewerage System Improvement Program is replacing existing aged infrastructure but also taking a more sustainable approach to the use of wastewater and urban run-off. The Bond is helping to finance projects that address water efficiency reuse and conservation as well as upgrading

existing processing capability.

“Our city’s sewer system was built to last a hundred years; it’s only fitting that we use the latest, most innovative financing techniques to ensure our infrastructure can overcome future environmental challenges while meeting the needs of our community for the next 100 years,” said Harlan Kelly, General Manager, SFPUC.

The Climate Bonds Water Criteria have been created to provide investors with verifiable, science-based criteria for evaluating bonds earmarked for financing sustainable water infrastructure projects.

These criteria focus on vulnerability assessment, climate mitigation and adaptation planning in projects as diverse as energy or industrial water efficiency through to large-scale water infrastructure development and are aimed to help corporate, municipal and other bond issuers expand their fixed income green bond offerings in water-related projects.

“There is a slow response amongst some US municipal bond issuers and traditional bond investors in acknowledging that climate change impacts must be factored into various aspects of urban planning and services including water and water infrastructure,” added Leigh-Bell. “They are not fully aware of the hidden risks. This in turn impacts the assessments of the future water environment and availability how various resilience and adaption factors should be considered and included in provision of water services.”

Cities Today

by Nick Michell

27th May 2016

[Why Ohio Wants a Bond Bank.](#)

DALLAS – Smaller Ohio governments would enjoy easier bond market access at lower costs through a state bond bank, say supporters of legislation to create one.

House Bill 435 passed the House on May 18 on a 95-1 vote and has strong bipartisan support from legislators and Gov. John Kasich’s administration, said its sponsor, Rep. Jeff McClain, R-Upper Sandusky.

“The rules, laws and everything about issuance of bonds under the bond bank legislation is exactly the same as what we already have for bond issuance in the state of Ohio,” McClain said. “The hope is that we will be able to pool some of the smaller entities like townships and villages and they can take advantage of a bigger pool and better rates.”

McClain worked in conjunction with the state treasurer’s office on the bill.

“The goal of the bond bank is to allow local governments to borrow at a lower cost than they could achieve on their own,” said Amanda Merritt, press secretary for Treasurer Josh Mandel. “The bond bank can potentially provide significant cost savings to local government issuers with reduced interest rates and reduced costs of issuance.”

The governing rules for the proposed bond bank would allow it to issue bonds and use the proceeds to make loans to local governments throughout the state at their request.

The entity could consolidate local bond issues to create a single, pooled issue, allowing smaller local governments the advantage of accessing the state's investment grade ratings.

Under HB 435, the Treasurer's office would administer the bond bank. Like the existing Ohio Market Access Program (which received the 2014 Bond Buyer Small Issuer Deal of the Year Award) and the State Treasury Asset Reserve of Ohio Program, the bond bank would be another treasurer's office program designed to benefit local governments.

As with those programs, the bond bank would be entirely voluntary, with the goal of giving local governments additional low-cost financing options. In terms of savings, ratings and the number of issuances per year, it's too early to say.

Supporters say a bond bank structure spreads risk, netting better interest rates and lower issuing costs.

Market participants say the benefits are clear.

"The bond bank recognizes that the implicit credit of the state is valuable in reducing the cost to its cities of capital financing for that infrastructure so essential not just to health; drinking water, police & fire stations, etc.; but also to public infrastructure investment from wastewater to bridges, etc. — investments which are fundamental to the overall state economy," said Frank Shafroth, director at the Center for State and Local Government Leadership at George Mason University.

Progress on the bond bank comes in a state funding environment that has been hostile to local governments.

"The state really hammered local governments with three blows: they cut the local government fund in half, they phased out property tax and eliminated the estate tax," said Wendy Patton, the Senior Project Director at Policy Matters Ohio. "All of those funds could be used for operation by localities and that is where the real loss and injury has been."

Municipalities saw the Local Government Fund, critical to the survival of many local services, cut in half five years ago.

Under the LGF, established in the 1930s, local governments receive a set percentage of all taxes collected by the state.

"In some cases these funds are essential to the very survival of some local governments," said Shafroth.

The state legislature also eliminated the estate tax in Ohio in the 2012-2013 budget. Local governments received 80% of the revenue; in the last year of existence it contributed between \$220 and \$300 million, according to Patton.

"Local governments looked to that source as a capital fund for replacing vehicles or capital goods that was eliminated and it was a major source of funding for capital infrastructure," said Patton. "To the extent that communities are facing needs for capital goods and are lacking the estate tax to build up a fund ... the state bank would be helpful as a source of funding for capital needs."

The bond bank, while making lower cost capital funding available, won't substitute for the loss of

unrestricted funds such as those lost from the LGF, which typically funded operations.

“The state bond bank won’t address that loss,” said Patton.

Cuts to local government are evident in East Cleveland; on April 27, Mayor Gary Norton Jr. formally petitioned State Tax Commissioner Joseph Testa for permission to file for Chapter 9 bankruptcy because is struggling to meet payroll and benefit obligations because of a revenue crunch that is not likely to ease.

The city’s major sources of revenue come from income taxes, local government revenues distributed by the state, property taxes, and trash collection fees, as well as a street lighting assessment. The city has seen steep reductions in the past few years. It has no bond debt.

“Because of disparities between communities, those with the greatest needs for infrastructure investment — think East Cleveland — confront the greatest borrowing costs; so the state has significant incentives to help not just level the playing field, but also to leveraging capital investment in ways that will help the underlying state economy,” said Shafroth.

If the Senate passes the legislation, Ohio would join other states that use bond banks to pool borrowing capacity for smaller local governments and projects.

“The structure of a number of other states’ bond banks were considered in the creation of HB435, though the proposed bond bank is set up to best meets the needs of Ohio’s local governments,” said Merritt.

McDaniel said that in the development of the Ohio legislation there were some “conversations” about how Indiana modeled its bond bank.

The Indiana State Bond Bank was established as a self-supporting quasi-government entity by the Legislature in 1984. A seven-member board oversees the Bond Bank, with the Treasurer as the chair of the board. The Public Finance Director of the Indiana Finance Authority is statutorily appointed, with the remaining five members being appointed by the Governor.

As with Indiana’s bond bank, Ohio’s local governments would be on the hook for repaying bondholders, not the state.

“Ohio’s current legislation does not provide for any state backing of the bonds, but does contemplate an intercept mechanism,” said Merritt. Intercept mechanisms on revenues, such as state aid, give potential investors some comfort that borrowers will be forced to make good on their obligations.

The state is rated AA-plus by S&P Global Ratings and Fitch Ratings and Aa1 by Moody’s Investors Service.

The Bond Buyer

By Nora Colomer

May 24, 2016

Municipal Bonds Start to Stumble.

Muni bonds have been terrific investments, but as demand has risen, they've grown expensive. Investors should be cautious.

Municipal bonds have been terrific investments for the past year. The average national intermediate muni-bond fund is up more than 5% in that time, with the best performers topping 8%. Since munis are tax-advantaged, those returns are even better.

But with that magic combination of safety and yield, munis have also been in huge demand—and have gotten expensive. Yields, which move inversely to prices, are lower, especially relative to Treasuries.

It was only a year ago that high-rated munis yielded more than Treasuries in longer-term maturities. Now top-rated 10-year munis yield about 1.5%, less than the 1.8% yield on the 10-year Treasury note. Mid-month, long-term munis hit 2.4%, near their lowest yields in history, says Vikram Rai, who heads municipal strategy at Citigroup.

Now the Federal Reserve is threatening to raise rates this summer. Following the May 18 release of minutes from the Fed's April meeting, Treasury prices fell, as did prices of high-quality munis. An increase in new supply also contributed to munis' recent dip—and that could be just the start.

"These yields are at such low levels that I think the muni market offers very little protection against a rise in rates over the next 12 months," says Jim Kochan, chief fixed-income strategist at Wells Fargo Funds. Even though munis won't move as much as Treasuries, if and when the Fed hikes, fund investors could see negative returns, he warns. Of course, investors who hold individual muni bonds to maturity needn't worry about falling prices.

Riskier high-yield munis haven't fallen in price—in fact, they are getting more expensive. Nicholas Venditti, a muni-bond portfolio manager at Thornburg Investment Management, worries that muni investors are overloading on lower-quality and long-term bonds. "If and when there is a reversal, investors who are stretching for yield in an environment where they are not being adequately compensated are going to get hurt the most," he warns.

Fans believe huge demand will keep muni funds afloat. But supply is building as municipalities take advantage of extremely low rates. Kochan warns that the investor appetite for munis—which has spurred massive inflows into muni-bond funds—can reverse quickly if prices start to fall.

NONE OF THIS MEANS investors should rush to sell munis. But those with new money to deploy should note that high-quality corporate bonds yield upward of 3%, more than munis even after taxes are taken into account, says Michael Sheldon, chief investment officer at Northstar Wealth Partners.

Reducing risk by buying shorter-term, higher-quality munis makes sense for investors who stretched for yield. "Stick with quality," says Jim Grabovac, a senior portfolio manager at McDonnell Investment Management. "That's the best defense against a rocky rate environment."

Constructing a laddered portfolio, made up of bonds with a range of maturities, is a good strategy in a rising-rate environment since each year a new crop of bonds matures and can be reinvested at higher rates, says Sheldon. Venditti manages the Thornburg Limited Term Municipal fund (ticker: LTMFX), which ladders bonds with an average maturity of less than five years.

Citi's Rai prefers a barbell approach—one which favors both short-term and long-term bonds—since

it allows investors to benefit from a flattening yield curve. If the Fed hikes, longer-term bond yields are likely to fall, gaining in price. While short-term yields would rise, they wouldn't lose much value because they have very low duration.

Rai doesn't think muni yields will rise much since extremely low—and negative—rates around the world will keep a lid on rates in the U.S. He also thinks that munis may rally if the Fed doesn't hike this summer. Still, investors may want to play it safe by giving up some yield and taking less risk.

BARRON'S

By AMEY STONE

May 28, 2016

Buyer Beware: New PA Law Opens Riskier Investment Options for Local Governments.

HARRISBURG — As anyone with a savings account knows, the money in that account has earned virtually nothing for several years.

It's a lingering effect of the global financial meltdowns that occurred when banks' subprime mortgage pools sank in 2007, causing those same institutions to stop lending one another money the next year, which led to a credit crisis that spiked short-term interest rates. In response, the Federal Reserve has kept interest rates low to spur more borrowing and speed up the economic recovery.

But if the feds aren't raising interest rates, banks aren't either. That's why your savings account is earning far below the 4 to 5 percent it earned before the financial meltdowns.

Well, your local school district, borough and township have the same savings account problem.

In response, the Legislature and Gov. Tom Wolf have given local governments the chance to earn more interest under a new municipal finance law that took effect Tuesday. But with that newfound investment power comes greater risk of financial loss to taxpayers.

The law, known as Act 10, legalizes several short-term financial instruments that had been prohibited for most of the state's 67 counties, 500 school districts, 957 boroughs, 1,454 townships and the quasi-public municipal water and sewer authorities.

Some financial and legal experts are urging local elected officials to use caution and education when listening to salesmen who might tout the investments' benefits while glossing over instruction manuals and repercussions of misuse.

"Some of the investments are far more complicated than what was available previously," said Stuart Knade, chief counsel of the Pennsylvania School Boards Association, which has hosted seminars and delivered a webinar about the new law to its members. "I would hope most school districts would go into this cautiously."

Before the law, most local governments had limited and different investment options compared with their brethren in other states. With the exception of Philadelphia and Pittsburgh, most Pennsylvania local governments were only allowed to invest taxpayer money in financial instruments that were

issued and protected by the U.S. Treasury or covered by a bank's collateral.

The new law unifies local government entities under one investment law. The law also opens up investment options, all of which carry varying degrees of default, interest or credit risks.

The options are mortgage-backed securities offered by government-sponsored enterprises such as Fannie Mae and Freddie Mac; corporate capital loans known as commercial paper; non-collateralized negotiable certificates of deposit; collateralized loans known as repurchase agreements; and shares in money market funds operated by investment companies such as Vanguard and Fidelity.

With the exception of the mortgage-backed securities, all investments have time limits for how long a government can hold them, between 180 days and three years. All the instruments must be highly rated by at least two nationally recognized credit-rating agencies, such as Moody's, Standard & Poor's or Fitch.

Those investment rules also now apply to state-based investment pools such as the Pennsylvania Local Government Investment Trust. Created in 1981, the trust holds more than \$3 billion in investments for 2,900 local governmental entities and is managed by one of the state's largest financial investment companies, Public Financial Management.

If used wisely with a diversified investment portfolio, the law should be relatively safe, said Lou Gattis, a finance professor at Penn State University's Smeal College of Business.

"However, more choices does create the possibility of greater confusion and misuse," he said.

The confusion and misuse, he warned, would arise if local officials do not understand what they are buying or try to double down on losses.

"Many colossal losses start with small losses that are hidden, held too long, or made worse by 'doubling down' to recover the losses," Gattis said.

There is no gauge for how many local governments may opt for the new investments, said Chris Cap, executive director of the state Association of Boroughs.

"Yet many are inquiring about their benefits and consulting with their investment advisers on the local level," he said.

In using the new law, local officials should keep in mind the 2007-08 financial crisis, said Anne-Marie Anderson, a professor of finance at Lehigh University in Bethlehem. That crisis was caused by poor risk management by professional financial people who were more interested in turning a profit than in minimizing market exposure, she said.

"If the school board buys what the trader is selling without doing their due diligence or without setting up an oversight committee, they run the risk of buying junk," Anderson said.

But Doug Hill, executive director of the County Commissioners Association of Pennsylvania, sees no downside in the law. It simplifies and unifies the investment rules for all local governments, he said. The law's safeguards, he said, will ensure taxpayers are protected.

The law was needed to level the investment playing field among government units, said Dave Sanko, executive director of the Pennsylvania State Association of Township Supervisors.

"In the period of ongoing low interest rates and rates of return for investments, this provides another tool for communities to earn a little extra interest to avoid property tax [increases]," Sanko said.

The communities that opt to use the law, Sanko added, will only make about two-tenths of a percent more on interest. On a \$1 million investment, Sanko said, that equates to about \$2,000 in earnings in a climate where every little bit counts to avoid tax increases.

The change in the law was suggested by community bankers and officials at the trust to give local governments more investment options, said Rep. Kate Harper, R-Montgomery, the bill's primary sponsor. Since the market crash in 2007-08, she said, interest rates have been so low, no one, including government, is making enough money on interest to help cover expenses.

"No one's made money since 2008," Harper said. "The idea is to recognize where local governments could invest."

The law also has built-in protections, she said, such as time limits and credit reports of the investments. In addition, she said, the law does not permit all of the investment instruments bankers and the trust wanted, such as derivative swaps.

Swaps, legal under a 2003 law, are layered on top of variable-rate bonds. They are private contracts with investment banks that call for bond issuers and banks to bet on interest rate swings.

Used appropriately, swaps are hedges against potential increases in the interest rate of the underlying bonds. Used inappropriately, swaps become speculative tools that can over-leverage risk, as the Bethlehem Area School District found out when the mortgage and credit crises hit and taxpayers got crushed with skyrocketing interest payments. The district took out 17 swaps — the most of any school district in the state — between 2003 and 2009, and most have since been unwound at significant contract cancellation fees.

Swaps also are used in the banking and corporate finance world for some of the investment instruments listed in Act 10, such as negotiable CDs, bills of exchange and commercial paper.

But there is little chance financial advisers can use the 2003 law to layer a swap onto any of the Act 10 instruments, said Bruce Rader, a Temple University finance professor. The reason, he said, is that most of the Act 10 instruments carry short investment time frames, while swaps are typically put on bonds that have decades-long maturity dates.

Lawrence J. White, a New York University economics professor, agreed. The law seems safe, he said. If taxpayers get fleeced, the problem is not with Act 10, he said, it's with the lack of vigilance of local elected officials.

Local elected officials and their business managers do not have to be financial experts to handle the law, White added. They just have to know how to recognize the good financial experts from the bad ones, and that usually entails a cost, he said.

"Sorry, but expertise requires a price," White said.

And trust is not enough.

"There is a man," White said, "named Bernard Madoff."

And another named John Gardner Black.

Black, a small-time financial adviser, traveled Pennsylvania, from the Lehigh Valley to Lancaster to Butler County, selling school districts a bag of financial goods during Wall Street's technology investment bubble in the 1990s. His sales pitches, short on specifics and long on investment promises, were too good to be true.

In 1997, the Securities and Exchange Commission, during a routine audit, discovered Black was running a Ponzi scheme with \$233 million in taxpayer money. The SEC said Black was giving school officials fraudulent invoices and other records that hid \$71 million in investment losses and expenses. Black pleaded guilty in 2000 and got three years in prison for what was at the time the largest taxpayer fraud in state history.

Black's crimes went unnoticed for years because school officials did not ask the right questions and trusted his unbelievable claims on return rates, said Knade, of the school boards association. The saga, he said, highlights the need for elected officials to become knowledgeable of the complicated financial instruments they might be asked to consider.

The Black case can serve as a guide, he said, adding, "Someone once told me if someone guarantees you a rate of return, run the other way."

The Morning Call

By Steve Esack

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ACT 10 TIPS

Financial experts caution local governments to proceed carefully with the investment options that became available under a new law Tuesday.

- Diversify holdings across issuers, maturities, industries to ensure risks are not concentrated.
- Don't invest in any security you do not understand, especially if your adviser cannot easily explain the benefits and risks.
- Ensure the security meets investment objectives such as liquidity, income, growth, safety and time frame.
- Beware of securities that look too good.
- Understand that securities that offer high yield have higher risk.
- Communicate risks to stakeholders with periodic risk reports and open discussions.
- Don't hide investment losses or double down on them.

Source: Lou Gattis of Penn State University's Smeal College of Business

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GFOA: Understanding the Flaw of Averages.

Central to understanding risk is a concept called the “flaw of averages”—the idea that a single average number obscures the variation in the data. In “A Financially Resilient Organization is a Risk-Aware Organization,” a session at today’s annual conference in Toronto, Malisa Files and Sam Savage discussed uncertainty in financial planning. They pointed out that understanding potential variation from your average is key to understanding risk because you need to know how likely it is that your actual experience will come in under or over your estimate.

Files and Savage showed a model under construction by the City of Redmond, Washington, that is designed to help make the audience for the city’s forecast more aware of risk and better able to make decisions about resource allocation.

If you missed this session, you can see an [article](#) about this topic in the April 2016 issue of Government Finance Review.

Sunday, May 22, 2016

School Districts Discuss Aligning Resources with Student Achievement Goals.

For the second year in a row, GFOA hosted a luncheon for school districts to discuss GFOA’s best practices in budgeting for school districts. This year’s event featured four school districts – Portland Public Schools, Dayton City Public Schools, Upper Moreland Township School District, and Atlanta Public Schools – that have been on the journey toward optimizing the alignment between their limited resources and their student achievement goals. The districts discussed some of the challenges they faced, including the difficulty of prioritizing the many different, yet worthy, goals that their districts could pursue; changing the budget in a political environment; and grappling with limited resources. They also described the successes they’ve achieved, such as creating a partnership between the finance and academic offices; changing the tone of the budget the conversation to emphasize the effect of budget decisions on children; and building a team within the district to carry this work forward.

Learn more about the best practices for school budgeting at www.gfoa.org/school-budgeting. You can also visit SmarterSchoolSpending.org for case studies, tools, and templates to help you implement the best practices.

Monday, May 23, 2016

SIFMA Hosts Social Impact Investment Roundtable on Capitol Hill, Bringing Together Industry Experts and Lawmakers.

Washington, DC, May 26, 2016 – Today, SIFMA hosted a roundtable on Social Impact Investing with industry experts and Members of Congress. The event fueled a discussion between the financial services industry and Members of Congress, on the role of America’s capital markets in creating and funding programs designed to improve local communities. The event was held on Capitol Hill and

participants included Kenneth E. Bentsen, Jr., president and CEO of SIFMA, as well as Representatives Tom MacArthur (R-NJ), John Delaney (D-MD), Tom Reed (R-NY) and Jared Polis (D-CO). Industry participants included Audrey Choi, CEO, Institute for Sustainable Investing, Morgan Stanley; Stephen Freedman, Head of Thematic and Sustainable Investing Strategy US, UBS; and Navjeet Bal, Executive Vice President & General Counsel, Social Finance.

“Social impact investing is an innovative way to fund programs that fulfill a societal need. Discussions like today’s roundtable highlight the need for continuing dialogue between the public and private sectors in advancing social impact investing projects, as more communities turn to the capital markets to finance projects that have positive societal impact,” said Kenneth E. Bentsen, Jr., president and CEO of SIFMA.

The roundtable emphasized the role of America’s capital markets in enabling programs to improve local outcomes and help communities combat the challenges of long-standing problems such as poverty, pollution, and other social needs. The roundtable also provided an update on recent projects, results, and trends, as well as an outlook for the sector.

Participants discussed Social Finance’s Pay for Success Programs, such as the [Nurse-Family Partnership](#) in South Carolina and the Connecticut [Family Stability Project](#); and Morgan Stanley’s underwriting work for [Sustainable Neighborhood Bond](#), which funds affordable housing in New York, and its [Investing with Impact Platform](#) and [Sustainable Investing Portfolios](#), which allow investors of all sizes to invest with impact, making scale in the social finance market possible.

Audrey Choi spoke to how social finance is not only good for communities but can be profitable, among other examples citing a new [gender diversity investment framework](#) from Morgan Stanley’s Sustainable + Responsible Investment (SRI) and Global Quantitative Research teams which recognizes that companies with greater gender diversity can have improved performance. Stephen Freedman discussed UBS-commissioned report by CIO Wealth Management Research, [“On the Road to Parity: Gender lens investing.”](#)

Social impact investing is the investment of funds to opportunities or companies that have desirable environmental, governance or social factors, and is related to social finance. This involves the use of financial assets or instruments to fund projects that have a positive social or environmental impact.

While the idea of social impact investing started in the mid-1960s, it has traditionally represented a relatively small part of the market. However, from 2012-2014, U.S. based socially responsible assets under management almost doubled, from \$3.74 trillion to \$6.57 trillion. In addition, estimates project that social impact investment opportunities could constitute a \$10 trillion market by 2050.

Social finance programs commonly include the issuance of social impact bonds, or the design of Pay for Success programs, which involve public-private partnerships between private investors and public sector entities to achieve socially beneficial outcomes.

SIFMA plans to host its next congressional roundtable on cybersecurity on June 9 at 1pm, followed by a Biotech roundtable on June 23.

Release Date: May 26, 2016

Contact: Carol Danko, 202-962-7390, cdanko@sifma.org

[The Hidden Wall Street Fees That Could Be Costing Pensions \\$20 Billion a Year.](#)

A new report says the fees pension plans pay private equity and hedge fund managers aren't worth it.

The fees public pension plans pay Wall Street money managers — some of which go unreported — have come under increasing scrutiny in recent years. It's estimated that disclosed and undisclosed fees cost public plans upwards of \$20 billion annually, according to the author of a [new study](#).

That's a big dollar amount when you consider that public pension plans' collective unfunded liability is a little over \$1 trillion. So far, just a few state plans have been trying to get a handle on these fees. One of them, the California Public Employees Retirement System (CalPERS), reported late last year that it paid \$3.4 billion in undisclosed fees over the past 25 years on \$24 billion in total investment earnings. CalPERS is the nation's largest retirement system.

Jeff Hooke, a consultant for the right-leaning Maryland Public Policy Institute, estimates in the study that Maryland's public employees' plan paid \$500 million in 2014 — twice as much as it reported for that year. Hooke said that if other states' hidden fees are similarly underreported, the total fees pensions actually pay could be as much as \$20 billion annually. "And that's just for states — forget about all the counties and cities," he said, "which could easily add another 25 percent to that."

At issue are so-called performance fees, which private equity and hedge fund managers charge plans for any profits they generate. Pension plans generally disclose management fees but have avoided reporting performance payouts because they weren't required to under accounting rules and because they're hard to calculate.

Now states are [looking to bring these fees under control](#). Kentucky took a step in that direction last year when it revised its reporting policy to include more transparency on private equity fees. In 2015, the first year of the policy, the Kentucky Retirement System [estimated it spent](#) \$108.3 million in fees — a 75 percent increase over the amount reported in 2014.

Similarly, New Jersey and South Carolina also revamped their fee reporting. Since 2007, fees in South Carolina have gone [from \\$39 million to \\$468 million](#), an increase the system attributes to better reporting. New Jersey's pension system recently announced it [paid outside fund managers](#) \$328.4 million in performance bonuses last fiscal year, on top of nearly \$400 million in management fees.

Rooting out the true cost of private equity and hedge funds isn't just about transparency. It's also about making sure the high costs are worth the investment. Hooke argues that, at least in Maryland's case, it isn't. According to data from Boston College's Center for Retirement Research, the Maryland public employees' plan has underperformed its peers over the past 10 years on its average annual rate of return. State officials, which have butted heads with the policy institute before, defend the fund's private equity investments, arguing it has earned double-digit returns over the past decade, well above the fund's total target rate of return.

In South Carolina, Treasurer Curtis Loftis has loudly criticized his state's pension system's high fees for similarly meager investment performance compared to other plans. In a [report](#) last year to the state legislature, Loftis estimated the pension system would have saved \$7 billion in costs over 10 years if it had instead used that money to invest in index funds — low-fee portfolios that replicate the

movements of a specific financial market.

One pension fund is actually testing this performance theory. In 2013, the \$509-million Montgomery County Employees Retirement Plan in Pennsylvania shifted most of its investments to index funds. The county Board of Commissioners estimated at the time that the move could save up to \$1.3 million in annual management fees while potentially improving performance. In 2014, the county fund [reported](#) a total 7.7 percent on its investments while paying less than 0.9 percent of its investment income in fees. By comparison, the state public employees' pension fund [earned 6.4 percent](#) on its investments and paid out 11.4 percent of its total investment earnings to money managers.

In Maryland, the policy institute estimates the state employees fund has spent a similar percentage of its investments on fees over the past five years. The institute's president, Christopher Summers, said he hopes his group's report will encourage better data in Maryland and elsewhere so that lower-cost investments like index funds might be considered as an alternative.

"There's still a learning curve on this for public and elected officials," he said, "so we're trying to get as many educated as we can."

GOVERNING.COM

BY LIZ FARMER | MAY 24, 2016

[**An Argument For Using Tax-Exempts in P3 Structures.**](#)

BRADENTON, Fla. Tax exempt bonds give municipal issuers a unique advantage in negotiating public-private partnerships, a factor that some municipal market and legal advocates say should not be overshadowed.

The fact that tax exempt financing – the lowest cost of funding – is only available in the U.S. can be obscured as industry supporters encourage the broad use of public-private partnerships to fund large and small projects, they said.

"I've tried to make it clear that this is not a pot of gold at the end of a rainbow," said bond attorney Randall Clement of Bryant Miller Olive, who helped tweak Florida's P3 legislation earlier this year. "The private sector is in it to basically make a profit."

A governmental entity must look at the cost of financing and understand the benefits of what it is trying to achieve, while considering different approaches to accomplishing those goals, he said.

The tax exempt bond market has adequately financed infrastructure projects for decades, Ben Watkins, director of Florida's Division of Bond Finance, said at the National Municipal Bond Summit last month.

Watkins said he finds fault with the growing use of P3s based on the European DBFOM design/build-/finance/operate/maintain model, where a public entity uses a contractual agreement with the private sector to finance, design, construct, operate, and maintain a project.

"There is no rigorous analysis," he said, adding that feasibility assumptions of such P3s are embedded in paperwork done by industry insiders and supporters. "The recipient doesn't care about

the cost of financing, they just want the project.”

There are ways to deliver projects using P3s and tax exempt financing that provide significant benefits to public agencies, according to Matt Calcavecchia, a vice president at the nonprofit Public Facilities Group in Seattle.

“We could not agree more that the industry insiders have been leading this conversation and focused primarily on the DBFOM model,” Calcavecchia said after reading Watkins’ comments.

“But you must be able to access tax exempt bond financing in order to do so.”

Public Facilities Group, a new muni shop that focuses on social infrastructure financing, combines tax exempt bond financing with private development experience to significantly reduce the cost of a project, he said.

If the idea sounds familiar, it is.

The platform is similar to one created by the National Development Council called the “American model.”

It uses the private sector’s expertise to design and build a government project, while a private, nonprofit conduit issuer finances the project with tax exempt bonds and fulfills operations and maintenance duties over the life of a multiyear contract.

“We can marry those two into a [public-private] delivery system,” said PFG president John Finke, who helped pioneer the American model at NDC.

PFG, whose executives used to work at National Development, opened in January. The model that Public Facilities Group uses allows the public entity to take over maintenance and operations at any time even as debt is still being paid off, Finke said.

Finke said DBFOM contracts that span 30 years and 40 years often are not in the public’s interest.

“If you go to private financing and private equity, that’s so much more expensive,” he said. “From my point of view, taxexempt bonds are the most efficient source of project financing. No expensive equity is required.”

Companies in the P3 business want the profitability of a 40-year contract, and are paid back for their equity contribution, he said.

“I’ve never seen the private sector being fleeced in these deals.” Finke said. PFG typically structures its deals under the Internal Revenue Service’s Rule 6320, which allows a nonprofit public benefit corporation to issue taxexempt debt to finance the private development of a public project through a leaseback arrangement.

PFG can also structure a deal using a 501(c)(3) charitable organization structure.

In its “New American Approach” platform, each project has a single asset and its own board. “Local government has the right to replace that member with themselves or some other entity,” Finke said. “Then they have total control of the entity.”

Finke said his firm’s platform works well for projects costing as little as \$20 million.

PFG focuses on social infrastructure such as university housing, police stations and city hall,

biomedical research facilities, and hospitals. At this time it is not delving into larger infrastructure projects such as roads, bridges, water and sewer projects, or broadband at this time.

So far, 34 states have adopted legislation allowing P3s to be used by state and local governments, schools and special districts.

The laws typically provide the legal and financial frameworks necessary to pursue the partnerships.

The enabling laws provide “more clarity and certainty” for the private sector to jump-start the use of P3s, said Clement, who helped develop Florida’s enabling legislation in 2013.

Clement also advised Florida lawmakers earlier this year on tweaking the state’s P3 laws, in part to clarify that the legislation is an alternative to the powers that counties, cities, and special districts already process under state law.

Senate Bill 126, signed by Gov. Rick Scott, revises a number of provisions in the P3 statute and addresses concerns of local governments that believed the P3 law limited their home rule powers, Clement said.

“One of the clarifications of the bill was that it’s supplemental, in essence optional, and doesn’t take away [local government’s] ability or options to do projects,” he said. “It was really intended to clarify that the statute was not intended to erode their home rule powers.”

Florida’s law was never intended to dictate the structure or the terms of a P3 transaction, Clement said, adding that it is designed to provide a consistent framework to process P3 proposals.

Scott also signed SB 124 into law March 30. It temporarily exempts unsolicited P3 proposals from public disclosure until a local government decides whether to pursue the project.

Both bills go into effect July 1.

The Bond Buyer

By Shelly Sigo

May 25, 2016

[Legislators Sponsor Bills to Use P3s to Develop VA Facilities.](#)

A new Senate bill could pave the way for the use of public-private partnerships to develop facilities for military veterans.

[S. 2958](#), introduced by Sen. Deb Fischer (R-Neb.) on May 19, would set up a pilot program through which the Secretary of the Department of Veterans Affairs (VA) could enter into up to five P3s to build or modify medical facilities costing at least \$10 million or to build or expand VA cemeteries.

State or local agencies, nonprofit organizations, donors and private developers would be eligible to pursue such projects or donate funds to support them.

The bill specifies that one of these projects would involve the design, financing and building of a new ambulatory care center in Omaha, Neb., for which the secretary would be authorized to spend up to

\$56 million. The VA has expressed interest in building a clinic near an aging hospital in Omaha, reported [Omaha.com](#).

For each project developed under the legislation, the private partner would have to establish a board that would oversee project financing, design and construction. Each board must include a VA employee and a military veteran who is unaffiliated with the department.

The bill has been referred to the Senate Veterans' Affairs Committee.

This legislation is similar to [H.R. 5099](#), introduced by Rep. Brad Ashford (D-Neb.) in late April, which has been referred to the Health Subcommittee of the House Veterans' Affairs Committee.

May 26, 2016

[S&P's Proposed Changes In U.S. State Rating Methodology: FAQ.](#)

On May 25, 2015, S&P Global Ratings published a request for comment (RFC) on its proposed changes to the rating methodology for assigning ratings to U.S. states and territories. The comment period ends on June 27, 2016. This article addresses some likely questions following the release of the RFC.

Frequently Asked Questions

Why is S&P Global Ratings proposing changes to its U.S. state rating methodology?

The purpose of the proposed criteria is to align the pension assessment section of the criteria with accounting changes in Governmental Accounting Standards Board (GASB) 67 and 68, reduce volatility in certain factors, and to use related disclosure to enhance our analysis with a more comprehensive and forward-looking assessment of pension funding discipline. We also propose to revise and expand a few of our rating overrides and rating caps to provide for greater transparency for ratings below the 'BBB' category.

How do the proposed criteria differ from the current criteria?

We are proposing changes to our pension assessment and to several rating caps and overrides. Specifically, we propose to revise rating overrides for situations in which a state has weak liquidity and capital market access or a high level of expected future debt and liabilities. The proposal also includes additional guidance for overriding factors related to weak structural budget performance as well as high levels of contingent liquidity risk.

Another key difference is the proposed methodology to arrive at the pension score, although we would continue to analyze many of the same elements as we do today. Under current criteria, we average four indicators to arrive at the overall pension assessment. Under the proposed criteria, we would begin with an assessment of the pension funded ratio and pension funding discipline, as the anchors for the initial pension score. Then we would adjust the initial score in cases where we characterize the state's unfunded pension liability compared to population or income as extremely large or extremely small. We believe that the core focus on the pension funded ratio and funding discipline provides us with a more forward-looking measure of a state's potential future liability challenges.

How do the proposed criteria assess pension funding discipline?

We believe a commitment to funding annual contributions that address the long-term pension

liability is a key credit consideration. Our existing criteria assess a state's historical track record of meeting its annual required contribution. However, the new GASB accounting standards no longer define an annual required contribution and reported required contributions will vary based on funding policy.

Therefore, in addition to our analysis of a state's funding policy and track record, we are proposing to use additional disclosure provided by new GASB standards to evaluate whether plan contributions usually cover certain accrued annual costs, to offset annual growth in the liability and avoid negative amortization, as well as make some progress in funding the estimated liability over time.

Specifically, we propose to analyze whether total annual plan contributions are usually sufficient to cover the aggregate annual plan service cost, as well as an annual interest cost and amortization cost component. We assume that there is some amount of likely funding progress if the annual plan contributions cover (1) the present value of benefits earned by participants in the year, (2) a portion of the annual interest cost related to pension liabilities unmatched by plan assets, and (3) some amortization of the beginning unfunded pension liability.

We recognize that actuarial assumptions vary across plans. Therefore, we also propose to assess certain pension plan management characteristics and actuarial assumptions. What we view as particularly conservative or aggressive assumptions or management practices could influence our view of pension funding discipline.

What will be the rating impact? Will there be any changes to U.S. state ratings as a result of the proposed criteria?

We maintain ratings on all 50 U.S. states and two territories. Our testing suggests that there will be no rating changes as a result of the revised criteria.

Where can I get more information on the proposed criteria?

The RFC, "U.S. State Ratings Methodology," is on RatingsDirect and on www.standardandpoors.com. Further information will be provided via a webcast on June 7, 2016. Please see https://www.spratings.com/en_US/topic/-/render/topic-detail/u-s-states for relevant links to register for the webcast.

How long is the request for comment period? How do I submit comments on the proposed criteria?

We encourage all market participants to submit written comments on the proposed criteria by June 27, 2016. Please send your written comments to https://www.standardandpoors.com/en_US/web/guest/ratings/rfc. Once the comment period is over, we will review the comments, potentially adjust the proposed criteria to reflect relevant market input, and publish the final criteria. The final criteria will be effective immediately upon publication.

Only a rating committee may determine a rating action and this report does not constitute a rating action.

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S&P RFC: U.S. State Ratings Methodology.

S&P Global Ratings is requesting comments on proposed revisions to its methodology for rating United States state governments and territories. The proposed updates better align our criteria with new pension reporting and disclosure, and provide additional transparency and guidance with respect to potential caps and adjustments to the rating. "Rating" refers to the rating assigned to general obligation (GO) debt of U.S. states and territories or the issuer credit rating if no GO debt is outstanding. If the proposed changes are adopted, the new criteria will fully supersede "U.S. States Rating Methodology," published Jan. 3, 2011.

[Continue reading.](#)

25-May-2016

Loop Capital Municipal Strategy Report - May 2016

[Read the Report.](#)

By Analytical Services Division on May 20th, 2016

SIFMA Social Impact Investing and Social Finance Fact Sheet.

Social impact investing is commonly used to describe the direction of investment funds to opportunities or companies that have desirable environmental, governance or social factors (also called ESG investing), and is related to social finance, which involves the use financial assets or instruments to fund projects that have a positive social or environmental impact.

[Read the Fact Sheet.](#)

May 24, 2016

U.S. Tobacco Bond Market Shrugs Off Fitch Move to Ditch Ratings.

Fitch Ratings' announcement that it will pull its ratings on tobacco bonds sold by U.S. states and local governments was not shaking up the market for the high-performing debt on Tuesday.

Billions of dollars of bonds are backed by money from U.S. tobacco companies under a 1998 master settlement agreement (MSA) to compensate 46 states, Washington D.C., and Puerto Rico for the cost of caring for sick smokers.

Fitch on Monday said that recent side agreements between several states and tobacco companies that did not participate in the MSA regarding disputed payments "have eroded Fitch's confidence in the predictability of the calculation of MSA payments going forward."

The tobacco sector has not seen much negative movement since Fitch's announcement, said Chris Taddoni, vice president of municipal evaluated bonds at Markit.

The number of price quotes observed by Markit has remained consistent this week, suggesting that Fitch's action "is not having a huge effect on the market."

States have received more than \$50 billion so far under the MSA, according to the National Association of State Attorneys General, which manages the agreement.

Fitch said it will withdraw its ratings on tobacco bonds issued by Ohio, California, Puerto Rico, Michigan, Illinois, New York, and others on June 15. The credit rating agency did not respond to requests for further comment.

Moody's Investors Service and Standard & Poor's still rate tobacco bonds.

"I think that perhaps it just doesn't fit their process," said John Miller, co-head of fixed income for Nuveen Asset Management, regarding Fitch's action. "I'm a little bit surprised. It kind of looks like it's a lack of commitment to doing the analysis."

He added that tobacco bonds are in their third year of outperformance driven by stabilizing cigarette sales and investor demand for municipal bonds and high yields.

In the first four months of the year high yield tobacco bonds returned 9.4 percent, according to Barclays Capital, nearly three percentage points better than the next sector, transportation, which has returned 6.5 percent for investors.

Yields hit a high of 6.27 percent in some of the \$4.5 million traded in Ohio tobacco bonds with a 5.875 percent coupon maturing in 2047 on Tuesday, according to the Municipal Securities Rulemaking Board.

Dick Larkin, credit analysis director at Stoeber Glass & Co, concurred with Fitch's decision.

"So many side settlements, side negotiations and agreements that affect only handfuls of states have made forecasting issuer settlement payments totally unpredictable," he said.

REUTERS

NEW YORK/CHICAGO | BY HILARY RUSS AND KAREN PIEROG

May 17, 2016 5:58pm EDT

(Reporting by Hilary Russ in New York and Karen Pierog in Chicago; Editing by Daniel Bases and Chris Reese)

MuniServices Leads Program to Provide Essential Financial Administration Skills to Aspiring City Managers.

FRESNO, Calif., May 17, 2016 (GLOBE NEWSWIRE) — MuniServices, LLC, a business of PRA Group (Nasdaq:PRAA), in partnership with the California City Management Foundation (CCMF) and Saddleback College, will offer aspiring municipal leaders an opportunity to learn about strategic financial administration through the newly formed Municipal Financial Management Certification Program.

“Working intimately with municipal entities, MuniServices is keenly aware of the unprecedented pressure our public agency partners face on a daily basis to manage finances effectively,” said Julia Erdkamp, program chair and client services manager for MuniServices. “The Municipal Financial Management Certification Program is about empowering agencies to meet these growing challenges by providing current and future leaders with the knowledge and tools to navigate the complex terrain of local government finance.”

Designed for staff, analysts and managers currently working within local government, the five-course program will be offered through a series of web-based and in-person classes. Course offerings will include tax policy and revenue streams, accounting and budgeting, strategic financing, and leadership.

Through the program, students aspiring to leadership positions in local government will learn the ins and outs of municipal finance, giving them the tools and skills municipal leaders use each day to maintain fiscal accountability and control over department and program spending.

While these tools are essential for municipal leaders, a primary goal of the program is to teach government finance and leadership best practices that students can observe, understand and apply in their jobs.

Creation of the program is made possible by the partnership of the CCMF and Saddleback College, and the critical support of the Municipal Management Association of Southern California (MMASC). The CCMF provides access to key senior talent within the California city manager ranks. Saddleback College provides the academic rigor, course delivery platforms and educational expertise to ensure the program delivers on its promise of education.

“The California City Management Foundation is dedicated to supporting retired, current and future city managers throughout the state,” said CCMF Executive Director Ken Pulskamp. “Managing the finances of a city is no easy task and will likely become even more complicated over time. This partnership with Saddleback College is a perfect opportunity to assure that the next generation of leaders has the skill set needed to meet financial challenges head-on.”

“Saddleback College is proud to partner with MuniServices and CCMF to provide such a crucial program to local government agencies,” said Israel Dominguez, director of economic development and workforce development at Saddleback College. “Expanding the knowledge of decision makers in local government is truly a win-win that benefits the students and the communities they will go on to

serve. It is exactly the kind of role that a community college can fill.”

To learn more about the program, express an interest in participating, or to indicate an interest in teaching, visit www.muniservices.com/education or email Julia Erdkamp at education@muniservices.com.

MuniServices is one of the few firms in the United States offering the full suite of revenue enhancement services including revenue discovery, audit, collections and information services, encompassing every municipal tax source.

About MuniServices, LLC

Founded more than 35 years ago, MuniServices, a business of PRA Group (Nasdaq:PRAA), provides revenue discovery, recovery and compliance services to states and more than 1,000 municipalities nationwide with our PRA Government Services, Revenue Discovery Systems (RDS) and Broussard Partners & Associates (BPA) brands. Our efforts have resulted in reduced administrative costs and the identification of more than \$2.4 billion in unreported local taxes and fees. For more information, please visit www.muniservices.com.

About PRA Group

As a global leader in acquiring and collecting nonperforming loans, PRA Group (Nasdaq:PRAA) returns capital to banks and other creditors to help expand financial services for consumers in the Americas and Europe. PRA Group companies collaborate with customers to help them resolve their debt and provide a broad range of additional revenue and recovery services to business and government clients.

PRA has been recognized as one of Fortune’s 100 Fastest-Growing Companies for three years, one of Forbes’ Best Small Companies in America for eight consecutive years, and one of Forbes’ Best Midsize Employers in America in 2016. For more information, please visit www.pragroup.com.

Why Munis Are So Important For Infrastructure Projects.

WASHINGTON – The federal government and Congress need to play a more active role in securing infrastructure funding and protecting the tax-exempt status of bonds, said Jim McIntire, Washington state treasurer and president of the National Association of State Treasurers.

In a recent interview with The Bond Buyer, McIntire said that the muni bond market has been hampered due to stresses on state and local budget revenues. As tax reform proposals begin to surface in Congress, he said he wants to remind lawmakers that the nation’s infrastructure, including water and sewer systems, roads and schools are in need of “serious repair.”

“Repairing these systems and maintaining them is not something you can do easily or quickly. It takes a lot of planning and quite a bit of investment,” McIntire said. “It will take planning and broader policy thinking at the federal level.”

“It’s not just local in scope,” he added. “We’re talking about transportation – we all need to get goods across state lines. We have a common interest in getting states and localities to invest, but we need a federal frame for that.”

NAST leaders in February sent a letter to members of Congress urging them to support tax-exempt bonds as a key source of infrastructure funding in the wake of President Obama's proposed \$4.1 trillion 2017 budget that would tax the value of tax exemption at 28%.

NAST senior vice president and Oklahoma state treasurer Ken Miller said in the letter, which had more than 600 signatures from state and local officials as well as organizations, that a cap would place more of an onus on taxpayers to pay for projects in their communities.

"Municipal bonds have long been a vital source of funding for states, cities and counties to pay for essential infrastructure needs," Miller wrote. "Removing the tax-exempt status of these bonds for select taxpayers would cause a devastating ripple effect."

McIntire said in the interview that capping the value of the tax exemption for municipal bonds would raise borrowing costs for bond issuers as well as costs for taxpayers on state and local government projects. State and local governments also would have to use revenue from sales and property taxes to fill that gap, he added.

McIntire said there is broad bipartisan consensus among his fellow state treasurers around the issue of protecting the tax-exempt status of municipal bonds.

"Three-quarters of infrastructure in this country is financed by state and local governments and we are a major player in that," he said. "Almost all of that is financed with municipal bonds."

McIntire made his remarks just before the start of Infrastructure Week on Monday, which includes a series of panels, initiatives and other events across the country that highlight the importance of funding infrastructure projects.

The event has more than 100 government, business and labor affiliate organizations, including the muni bond advocate group Municipal Bonds for America, as well as dealer groups Bond Dealers of America and the Securities Industry and Financial Markets Association.

The theme for this year's Infrastructure Week is "Infrastructure Matters", with an emphasis placed on "roads, bridges, rails, ports, airports, pipes and the power grid," according to the event's website.

One positive for infrastructure is that Flint, Mich., which has been plagued by a water crisis for more than two years, may be aided by the Water Resources Development Act of 2016, which was passed by the Senate Environment and Public Works Committee last month. The bill, which is still pending in the Senate, would provide \$1.4 billion of federal funding over the next five years to "small and disadvantaged" communities comply with the Safe Drinking Water Act.

The Flint provisions had originally been included in the long-stalled Senate energy bill, but were removed in April.

Sen. Mike Lee, R-Utah, had placed a hold on the energy bill because of concerns the Flint provisions would prove too costly, suggesting instead Michigan tap into its \$386 million in rainy day funds or its \$575 million surplus from 2015 rather than seek federal funding.

McIntire lauded the five-year Fixing America's Surface Transportation Act that was enacted in December, but said federal leadership is still needed on how to finance transportation systems that can no longer be solely reliant on a gas tax because it has flattened or declined on a per capita basis.

Rural areas, he said, oftentimes don't have the rate base to afford, maintain and upgrade water systems. Older urban areas that have not experienced much economic prosperity or growth may also

lack the necessary tax base rate to make necessary infrastructure improvements, he added.

Rapid growth areas like Seattle in McIntire's state have their own set of infrastructure challenges that require tax-exempt financing. Washington had a population increase of roughly 150,000 people last year, many of whom moved in from out of state, which places more of a burden on state schools and roads.

"That's like adding another small city," he said. "It's about keeping up with those needs."

The Bond Buyer

By Evan Fallor

May 16, 2016

[Tennessee Enacts Public-Private Partnership Statute In Quest To Solve Growing Traffic Problems.](#)

Thanks to newly enacted legislation signed into law late last month, Tennessee may be one step closer to solving a critical problem facing residents and officials in Middle Tennessee: How to solve Nashville's growing traffic congestion.

An estimated 80 to 100 people are moving to Nashville each day. That is good news to private developers who continue to pour money into the area to meet the demand created by the rapid growth. Many of those people moving to Nashville want to live close to where they work or attend school. In Nashville, that typically means living somewhere between Downtown, the West End, and Green Hills—ground zero for Nashville's traffic congestion.

Most public officials who have looked at the traffic problem in and around Nashville agree more roads and bridges are not necessarily the answer. Nashville's Metro Transit Authority has been studying the issue for years and recently released several options being considered. Those options range in price from an estimated \$5.4 billion down to \$800 million. And those options all look at solving the problem with mass transit. While most all public officials and their consultants agree mass transit is the best way to solve the growing traffic problem, they also agree funding that solution is likely to be the biggest challenge. That is where the "Public-Private Transportation Act of 2016" steps in.

The new law authorizes agencies to pursue public-private partnerships (referred to as "Public-Private Initiatives" under the act) for mass transit and other related projects. The law was first introduced in January 2016, was signed into law by Gov. Haslam in late April, and becomes effective October 1, 2016. Once implemented, the law will allow the private sector to participate in the development of mass transit projects and, hopefully, provide a creative solution which avoids asking the tax payers to foot the bill through tax revenues.

Under the new law, agencies can either solicit competitive bids or proposals for a project or even receive and consider unsolicited proposals for certain transportation related projects. In the event an unsolicited proposal is received, the public entity will be required to take several steps, including advertising for competitive proposals for the same project.

Under Tennessee's law, a Public-Private Initiative is an agreement between a state, county, or

municipality (including agencies or authorities created by those entities) and a private entity whereby the private entity contributes equity, shares resources, or assists in the development of a transportation facility. The law, however, defines a “transportation facility” in such a way that it prevents highways, bridges, and tunnels from being funded by Public-Private Initiatives.

One question raised by several early Public-Private Partnership statutes was whether projects built under the enabling statute would be considered public or private under other laws like the states “little Miller Act” and mechanic’s lien laws. That question was raised in several states where a private entity developing a similar project defaulted on payments to contractors hired to build the project. The problem is that when a developer defaults on a private project, the contractors can assert a mechanic’s lien to recoup their costs incurred for building the project that the defaulting developer is unable to pay. Those liens, however, are generally not available on a public project or only extend to payments the public owner owes and has not yet made to its general contractor. Therefore, public entities generally require general contractors on public projects to post payment bonds which ensure contractors performing the work will be paid in the event the general contractor defaults. On this issue, Tennessee joins the majority of states who have recently enacted these laws by requiring private entities participating in a Public-Private Initiative to post both payment and performance bonds.

Ultimately, the new law gives public entities a way to fund mass transit and related projects (e.g., parking facilities, utilities, and related projects to support mass transit projects) without using tax dollars. At the same time, the new law creates opportunities for private investors and developers looking to invest in Nashville’s growth. Following the lead of at least 33 other states, including, most recently, Kentucky, Tennessee lawmakers believe Public-Private Partnerships will offer a solution to the traffic problem without dipping too deep into the public coffers.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Article by Zachary D. Jones

Last Updated: May 12 2016

Stites & Harbison PLLC

[The Fiscal Tools Cities Need to Pay for Infrastructure.](#)

They no longer can count on Washington or their states. They need the authority to find creative local solutions.

As the infrastructure deficit grows in our cities, so do questions about how to pay for these critical systems. Funding from the federal and state levels is uncertain at best, placing increasing pressure on local governments to take the lead. But political realities coupled with unequal access to local revenue tools means some don’t have the authority they need to answer the call.

In April, for example, voters in Pulaski County, Ark., rejected a quarter-percentage-point sales tax increase that would have been the area’s first tax dedicated to transit, projected to raise \$18 million annually for bus-service expansion and the creation of bus lanes. The proposed tax drew widespread support within the city of Little Rock, but not in other parts of the county.

Local governments in Arkansas are among those in 29 states that are permitted to levy a local-option sales tax. But even where that authority is granted, additional limitations on these powers stand in the way. Voter approval is just one implementation hurdle states impose on their cities. Others include rate caps and matching requirements that restrict the ability of cities to meet growing infrastructure demands.

The infrastructure funding relationship that cities have with their states is a complex one. Declining state gas-tax revenues have made state programs and funding to cities increasingly unreliable. Some states are even diverting dedicated gas-tax revenue to balance their state budgets or raiding local revenues to help fill their own maintenance funding gaps. In the rare instances where states have budget surpluses, as in Minnesota, lawmakers are favoring one-time spending increases on transportation over permanent tax increases.

State spending priorities, both for state capital program and infrastructure grants to cities, are often not aligned with city needs or priorities. For example, in New Hampshire, the state implemented a moratorium on aid grants for water and sewer projects even though cities had already completed some of the projects with the intention of using state grants to help retire bond payments.

In short, local governments' access to revenue-raising tools is highly uneven across the country. Our new report, ["Paying for Local Infrastructure in a New Era of Federalism,"](#) examines the wide variance: While 29 states authorize local-option sales taxes, for example, only 16 allow local-option fuel taxes. Twenty six states allow local-option motor-vehicle registration fees. Thirty-two states authorize public-private partnerships, and 27 have state infrastructure banks.

The way these tools work in each jurisdiction is very much dependent upon the political nuances, demographic makeup and the types of challenges specific to each city. The political landscape in many states is also antagonistic toward cities, particularly for new local taxes and transit projects that are perceived only to serve certain constituencies.

When paying for infrastructure becomes entwined with these sentiments, it is even more evident that cities and their local partners must find other ways. Cities with access to a state infrastructure bank, like those in California, are finding success, but often these banks are restricted to particular uses and particular cities within a state — if they are funded at all.

As a result of the limited options available to cities, some are exploring riskier ways to fund infrastructure, including [direct loans](#) and [pension obligation bonds](#). Some are turning to [smart-city technologies](#) to increase efficiencies and decrease costs, and others are looking to unlock the value from [underutilized assets](#) like parking, lighting and obsolete payphones.

The reason cities are experimenting with a patchwork of new and traditional tools and approaches is because they have to. More funding from federal and state partners would certainly be welcomed. Even more pressing is the need for greater communication and alignment of priorities between levels of government, along with the local authority to implement creative solutions to closing the infrastructure deficit.

GOVERNING.COM

BY CHRISTIANA K. MCFARLAND, NICOLE DUPUIS | MAY 20, 2016

What's Going on With Muni Credits?

The trend of local governments only seeking out one credit rating for bonds is growing. Now, one in five bonds issued in the municipal market has just a single credit rating assigned to it, according to data from Municipal Market Analytics (MMA).

This can be attributed to several factors. For one, fewer individual investors — the biggest users of credit ratings information — are directly purchasing muni bonds, so the demand for multiple ratings has lessened. Also, agencies are increasingly giving different ratings to the same bond, which “undermines the notch-by-notch value of individual rating assignments,” said MMA analyst Matt Fabian.

Along with this trend is another one: A significant portion of municipal issuers are worse off than they were at the end of the Great Recession. By the measure of PNC Capital Markets analyst Tom Kozlik, 20 percent of state and local governments have seen their underlying credit quality decline — some significantly so.

Kozlik blames this on one key fact: governments’ inability to balance their revenue and spending to live within their means. “Also,” Kozlik adds, “some state and local governments still have not grasped the scale, costs and risk that pension liabilities and other post-employment benefits still pose to credit quality and fiscal balance.”

The Takeaway: These two trends contribute to the mysterious reputation the municipal market has with outsiders. When even the credit rating experts can’t agree (note Chicago’s three different ratings from four agencies), it’s tougher than ever to generalize about the overall health of state and local governments. But if more of them continue to falter, it will undoubtedly invite assumptions about unsustainable governments everywhere.

GOVERNING.COM

BY LIZ FARMER | MAY 20, 2016

S&P Request for Comment: Charter Schools: Methodology and Assumptions.

S&P Global Ratings is requesting comments on proposed changes to its methodology for assigning ratings and related credit products to U.S. not-for-profit charter schools (charter schools).

[Read the RFC.](#)

May 19, 2016

S&P's Public Finance Podcast (Innovations In The Healthcare Sector)

In this week’s edition, Senior Director Kevin Holloran joins us to provide some insights on innovations and transformations occurring in the healthcare space.

[Listen to the podcast.](#)

Why Statutory Liens Matter in a Chapter 9 World.

CHICAGO – Municipal industry experts on Thursday urged analysts to continue focusing on how the presence of statutory liens can change the treatment of debt in bankruptcy proceedings and ratings analyses.

The experts discussed liens during a panel at the National Federation of Municipal Analysts' annual meeting here.

A statutory lien is a provision of a law that gives certain bonds held by investors a higher ranking in a bankruptcy recovery hierarchy than others without such liens. Some states, like California and Rhode Island, have passed laws that explicitly create liens, while the presence of liens for credits in certain other states is still debatable. The possible confusion is compounded even more because the characteristics of statutory liens may differ from state to state.

There is also a question of how special revenue and other pledges compare to statutory liens in terms of protecting bondholders.

The Detroit bankruptcy is one of the more recent events that led observers to question how liens may affect the assessment of debts in bankruptcy proceedings. However, Michigan statutes did not explicitly extend any liens to the debt considered in the Detroit bankruptcy proceedings.

Amanda Van Dusen, a principal with the law firm Miller Canfield, Paddock and Stone in Michigan, said that she didn't appreciate the significance of the word "lien" in a statute until she talked with bankruptcy lawyers.

"I thought, as most bond lawyers did, that a pledge means a promise," she said. "The first lesson that the bankruptcy lawyers pounded into me [was] ... that a pledge is a promise and in bankruptcy, promises are broken."

Richard Ciccarone, president and chief executive officer of Merritt Research Service, said that when he was given general obligation bonds that said they were payable from an unlimited tax, he viewed that as a pledge similar to a statutory lien.

"In a way, the pledge that was implied here was something we always believed was really like a common law marriage, you didn't really say yes to the vow, but you were married," Ciccarone said. "You may not necessarily find the words 'statutory lien,' but you believed it was a statutory lien."

Judge Frank Bailey, a U.S. bankruptcy judge for the District of Massachusetts, said Ciccarone was partially right because the bankruptcy code's definition of a statutory lien does not specify that the statute must use the words "statutory" or "lien" in creating one, only that the language match up to the definition outlined in the code.

The panelists also agreed that the lack of bankruptcy court decisions on statutory liens leaves observers with a lack of precedent. Most resolutions where statutory liens are involved come through negotiated settlements. The murky territory that liens currently occupy means industry participants need to talk more about what provisions borrowers may have, Ciccarone said.

“For the analyst still left in a world where [the consideration of statutory liens] is evolving, your responsibilities are going to be more burdensome,” he said. “If [issuers] think they have a statutory lien, we want that to be clear. If they don’t know, we want them to say they don’t know.”

Jane Ridley, a senior director and analytical leader with Standard & Poor’s, both moderated the panel and played a key role in a report released on Wednesday regarding the role of statutory liens in ratings.

The report acknowledged a recent trend, exhibited by Detroit, Puerto Rico, and earlier by Central Falls, R.I. in its bankruptcy proceedings, of legal provisions like pledges becoming less binding after earlier being widely considered unalterable. But it said ratings analysts should continue to rely more on an issuer’s fundamental areas of credit health than the presence of a statutory lien.

For example, the report wrote that if a rating agency was comparing two school districts, one with strong credit fundamentals but no statutory lien and one with weak credit fundamentals but with a statutory lien, “it is difficult for us to imagine a scenario where the latter would carry a higher issue credit rating.”

However, the report said that “the existence of legal protections can inform our opinion of the issuer’s incentive and ability to pay its various obligations.”

“Legal protections, whether in bond documents or by operation of law, can strengthen a bondholder’s recovery prospects,” the report said. “However, we’ve observed that when an issuer’s creditworthiness deteriorates to the point where bondholders’ main comfort is to rely on the legal provisions for payment, the situation isn’t nearly as straightforward as it may have appeared when the bonds were issued.”

The report also was in line with the panelists’ assessments of the lack of legal precedent, arguing that applying legal concepts outlined in negotiated settlements and incomplete case law to all of their ratings is “without analytical merit.”

The Bond Buyer

By Jack Casey

May 6, 2016

[Wall Street Sees Year of Progress and Pitfalls in Junked Chicago.](#)

Since Chicago was cut to junk by Moody’s Investors Service in May 2015, the city has sold more than \$3.3 billion of debt, allowing it to avoid potentially devastating bank penalties triggered by the downgrade, and pushed through a record property-tax increase.

But the triage over the last year has done little to loosen the financial bind that tarnished its standing on Wall Street in the first place: A \$20 billion pension-fund deficit that’s adding hundreds of millions of dollars a year to its bills, a legacy of long promising workers more in benefits than officials were willing to fund.

“All of this progress may not mean much if they don’t finish the job,” said Ty Schoback, a senior analyst at Columbia Threadneedle Investments, which holds about \$300 million of Chicago debt

among its \$25 billion of municipal securities. “They need to start finding the money to put into those funds now. Not six months from now. Not 12 months from now. They need to do it now.”

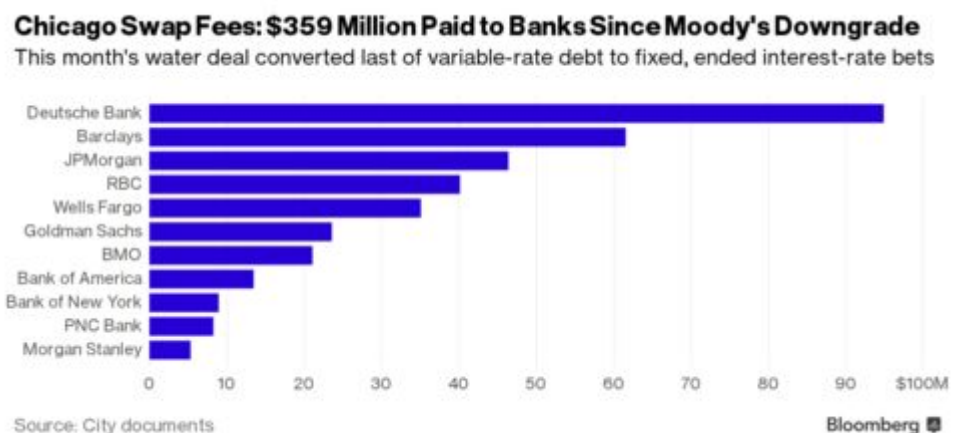
The Windy City, the biggest in the U.S. with a below investment-grade rating, has become a key locus of distress in the \$3.7 trillion municipal-bond market, contending with some of the same strains that helped push Detroit into a record bankruptcy three years ago. Reeling from debts that have been building for decades, Chicago’s push over the past year to steady its finances illustrates the difficult way out for cities and states that have saved \$1.7 trillion less than they need to cover pensions due in the years ahead.

“We have overcome a large number of hurdles,” Chicago’s budget director Alex Holt said in an interview at City Hall. “It doesn’t mean that there are not some big hurdles that are ahead of us, particularly in the case of pensions.”

Chicago underfunded its retirement system by \$7.3 billion in the decade through 2014, city records show, freeing up cash to spend on salaries, roadwork and other routine bills. That’s put it under pressure to set more taxpayer money aside to keep from falling further behind.

The Moody’s downgrade threatened to worsen the city’s financial burdens by exposing it to as much as \$2.2 billion in costs to repay floating-rate debt early and call off related derivative trades, which banks had the right to demand. To skirt that, the city pushed through a wave of bond issues as investors demanded yields higher than those on some speculative municipal securities.

It also paid \$359 million to scuttle the interest-rate swap contracts, eliminating the risk of having to settle them when money couldn’t easily be raised.

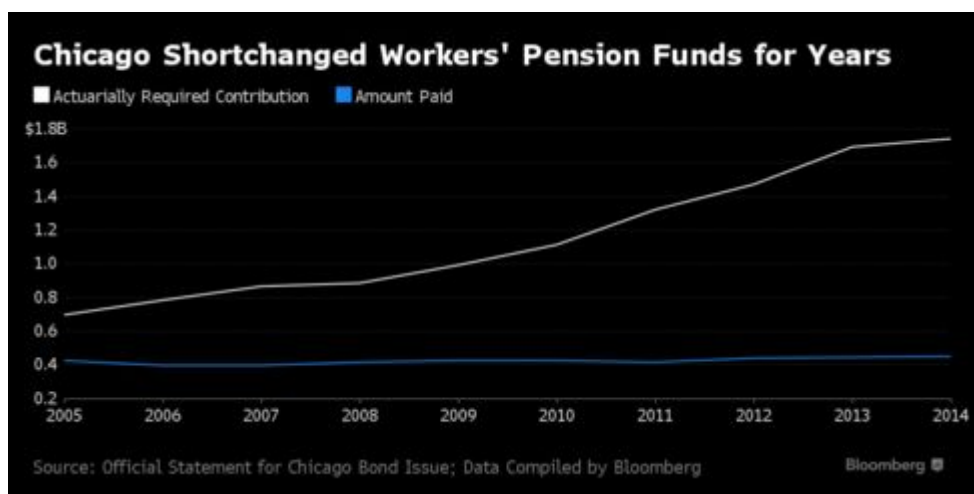


“They acted quickly,” said John Miller, co-head of fixed income at Nuveen Asset Management, which oversees \$110 billion of municipals and bought Chicago debt after the downgrade. “The rates they’re getting on the new issues that they’ve done are pretty manageable.”

Chicago also showed elected officials are willing to raise taxes to chip away at the debts. With support from Democratic Mayor Rahm Emanuel, who was re-elected to another four-year term in April 2015, the city council in October voted to boost real-estate levies by \$543 million over four years, the biggest jump ever.

The increase will bolster funding for two of its funds, the police and fire pensions, which were only about a quarter funded as of December 2014. Even so, Emanuel has petitioned Illinois Governor

Bruce Rauner to let the city put off about \$845 million of pension payments it's supposed to make over the next five years, which would add to future bills. Rauner has until May 31 to approve that law, which would give the city 40 years — instead of 25 years — to make its retirement plans 90 percent funded.



Even with the property-tax increase, the pension obligation is poised to grow each year and the city has little power to alter benefits. In March, the Illinois Supreme Court dashed Emanuel's plan to cut cost of living adjustments and require workers and the city to pay more into the municipal and laborers pensions.

"We acknowledge the steps that the city has taken over the last few months," said Matthew Butler, Moody's lead analyst on Chicago. "The path to improving the pension situation is likely going to be on the city. It's going to be increasing contributions to those plans."

The city is working to come up with a new way to shore up the pensions, including how to raise revenue, according to Chief Financial Officer Carole Brown. The municipal and laborer plans are on track to run out of money in 10 and 13 years, respectively. If they do, more than half of the budget could be devoted to retirement bills, according to Moody's.

Any overhaul may prove politically difficult. Sixty-two percent of Chicago residents disapprove of Emanuel's job performance, according to a survey by the New York Times and the Kaiser Family Foundation released this month. The mayor's standing has been weakened since last year's release of a video showing a white police officer shooting a black teenager 16 times, which sparked protests decrying the law-enforcement tactics used in Chicago's minority neighborhoods.

The ongoing financial uncertainty has pushed investors to demand high yields to hold Chicago's bonds instead of top-rated debt, even though the city's borrowing costs have dropped amid a rally in the municipal market.

Chicago bonds issued two weeks after the Moody's downgrade that mature in 2037 priced to yield 5.77 percent, data compiled by Bloomberg show. By contrast, investors demanded just a 4.88 percent rate on a portion of the city's January bond offering due in 2038.

Those bonds still trade at a higher rate than debt issued for an upstart methanol plant in Texas, a fertilizer facility in Iowa and even some junk-rated tobacco bonds, which Moody's projects to almost-surely default. Chicago's city council on Wednesday approved selling an additional \$600 million of general-obligation bonds, an issue that's set to come to market in the third quarter.

The volatility that rattled bondholders after last year's downgrade is likely to be more muted, said Nuveen's Miller.

"The move last summer was the big one," said Miller, who may buy more Chicago debt. "You have to be prepared for bumps in the road on a credit like this, but I don't think they'll be 200 basis point moves, and you can earn a decent amount of yield along the way."

Bloomberg Business

by Elizabeth Campbell and Brian Chappatta

May 18, 2016 — 2:00 AM PDT Updated on May 18, 2016 — 11:22 AM PDT

Tobacco Bond Ratings From Fitch Will Be Withdrawn in 30 Days.

Fitch Ratings plans to withdraw its ratings on all tobacco bonds in the \$3.7 trillion municipal market in 30 days because the company doesn't believe future payments from cigarette makers can be predicted reliably.

Two settlements, one with New York and another with California and 23 other states, modified calculations outside of the original parameters prescribed as part of the 1998 settlement with Reynolds American Inc., Lorillard Inc. and Philip Morris USA, Fitch said Monday in a report. Under the pact, the companies agreed to make annual payments to states in perpetuity to settle liabilities for health-care costs tied to smoking. The amount was distributed according to allocation percentages.

"There was historically a single, consistent application of the calculation adjustments that affected all participating jurisdictions in the same way," Fitch analysts Steven Stubbs, Rodney Pelletier and Kevin Duignan wrote. "However, more recent settlement agreements related to disputed payments connected to the non-participating manufacturer adjustment have eroded Fitch's confidence in the predictability of the calculation of MSA payments going forward."

In October, New York Attorney General Eric T. Schneiderman announced a settlement that releases money from an escrow account to the state, counties and New York City. The funds had been withheld since 2003 because of a dispute surrounding the 1998 settlement. Going forward, 90 percent of previously trapped funds will be released and the state has no risk of losing future annual payments as the result of arbitration proceedings.

Significant Trend

The settlements highlight uncertainty in the \$34 billion corner of the municipal market because some states could be vulnerable to an outsized adjustment in cigarette-company payments, Fitch said. High-yield tobacco bonds rallied by the most in nine months after Schneiderman's announcement.

"The significant trend toward material, and different settlements, the introduction of new variables with little analyzable history, and the incentives in place for additional settlements erode our confidence that a consistently reliable structured finance rating methodology can be applied going forward," the Fitch analysts wrote.

California's Golden State Tobacco Securitization Corp. and Ohio's Buckeye Tobacco Settlement Financing Authority are the two biggest issuers of the debt, data compiled by Bloomberg show. Fitch rated each of the agencies' single-largest securities CCC, the fifth-lowest grade and worse than the ranks from Moody's Investors Service and S&P Global Ratings.

In a \$55,000 trade on Tuesday, the junk-rated Golden State debt due in 2047 traded at 101.8 cents on the dollar, to yield 3.89 percent, the lowest in a month, data compiled by Bloomberg show. In a \$2.78 million exchange, investment-grade California tobacco bonds traded at 121.9 cents, the highest since May 5.

High-yield tobacco bonds have returned 11.2 percent this year, compared with 3 percent for the broad municipal market, Barclays Plc data show. Since the start of 2014, the debt has surged 53 percent.

Bloomberg Business

by Brian Chappatta

May 16, 2016 — 1:37 PM PDT Updated on May 17, 2016 — 6:53 AM PDT

[As Junk Rallies, Tribal Startup Sets Riskiest Muni Bond in Years.](#)

In a municipal-bond market flush with cash chasing the riskiest securities, a new business created to sell propane to American Indian tribes is planning to issue debt that, from the start, is seen only a few steps away from a default.

The venture, set up by a Dallas-based company, is aiming at a problem that's vexed remote reservations in the Great Plains: winter fuel scarcities, which have led to price spikes and left some impoverished residents unable to heat their homes. The \$22 million sale, which is slated for sometime in the next two months, would be used to buy propane when prices are low, store it and truck it in when needed. Revenue from those sales would repay the debt.

Bondholders may be out of luck if the business fails to get enough tribes to sign on, according to Moody's Investors Service, which said only three had by early May. So it rated the securities Caa2, eight steps into junk, the lowest grade it has given a new bond offering in at least six years. The rank indicates "very high credit risk."

"Anyone who buys will have had to have done extensive due diligence," said Peter Block, managing director with Ramirez & Co., a New York bond underwriter that isn't working on the deal. "Hard to say who will be interested in this."

Now is a good time to find anyone who is. With municipal-market yields the lowest since the 1960s, investors have been snapping up the worst-rated bonds, which have bigger payouts because of the risk. That has fueled a rally in speculative securities issued by state and local government agencies, including bonds repaid with tobacco-company settlements that rating companies say are almost certain to default.

Individuals added \$310 million to funds focused on the riskiest municipal debt in the week ended May 11, the most in about four months, according to Lipper US Fund Flows. With money coming in, the assets of such high-yield funds have climbed to a record \$82 billion from \$58 billion at the start

of 2014, according to data from Morningstar Inc. and Lipper.

The debt for the Infrastructure Development Cooperative's energy business would be sold through the Madison, Wisconsin-based Public Finance Authority. The agency, which rents out its access to the tax-exempt market for a fee, has raised money for charter schools, real estate developments and other projects in more than a dozen states. Scott Carper, the authority's program manager, declined to comment.

L. Steven Haynes, the founding partner of Haynes Investments, an affiliate of Highland Park Management LLC — which Moody's says is overseeing the project — didn't respond to telephone calls seeking comment. Haynes Investments, which is based in a hangar next to Dallas's Love Field airport, describes him as "one of the leading business executives in Native American project finance."

Gabe Doney, executive director of Tribal Infrastructure Development Cooperative, a Valentine, Nebraska, supplier of products and services to American Indians, said in an e-mail that he is Haynes' partner on the deal. Doney said the group's goal is to sell the bonds within the next 60 days.

"We are still working toward our bond," said Doney. "Once we have everything taken care of we would be willing to discuss it."

The business may fill a chronic need. In winter, those living on reservations are routinely squeezed by propane shortages that push retail prices to unaffordable heights, said Gavin Clarkson, American Indian finance scholar at New Mexico State University.

In 2014, the governors of several states signed emergency declarations making it easier to truck in supplies after a shortage led to at least one death at the Standing Rock Sioux reservation, which straddles the border of North Dakota and South Dakota.

"People can't afford to heat their homes so they risk freezing to death," said Clarkson. "It's a solid business concept, but the question is whether the tribes can execute."

The business' ability to generate revenue adequate to repay the bonds is the biggest challenge. Though it identified "significant" demand among 37 tribes, it has only signed agreements with three of the 10 it has targeted as initial customers, Moody's said in a May 11 report. Borrowing without enough agreements makes the deal "highly speculative," even though some of the proceeds will be used to cover the first three years of interest payments, according to the credit-rating company.

"The potential exists for significant shortfalls in net revenues," Moody's said.

Bloomberg Business

by Darrell Preston

May 20, 2016 — 2:00 AM PDT Updated on May 20, 2016 — 8:41 AM PDT

[GASB Posts New Page for Financial Statement Users.](#)

Financial reporting is a communication between governments and financial report users. The GASB's goal is to set accounting standards that yield information that users need to assist them in

making decisions about a government and to assist them in assessing whether it has been accountable for the resources that have been entrusted to it.

While we believe sound financial reporting helps financial report users to make informed decisions, it is important to note that the GASB always carefully weighs the cost of making changes against the benefit of those changes to users.

[Continue reading.](#)

U.S. Municipal Credit Report, First Quarter 2016.

The municipal bond credit report is a quarterly report on the trends and statistics of U.S. municipal bond market, both taxable and tax-exempt. Issuance volumes, outstanding, credit spreads, highlights and commentary are included.

Summary

According to Thomson Reuters, long-term public municipal issuance volume totaled \$96.5 billion in the first quarter of 2016, an increase of 26.2 percent from the prior quarter (\$76.4 billion) but a decline of 7.3 percent year-over-year (y-o-y) (\$104.0 billion). Including private placements (\$2.6 billion), long-term municipal issuance for 1Q'16 was \$99.3 billion.

Tax-exempt issuance totaled \$89.3 billion in 1Q'16, an increase of 32.6 percent q-o-q but a decline of 5.9 percent y-o-y. Taxable issuance totaled \$6.4 billion in 1Q'16, an increase of 23.8 percent q-o-q but a 6.4 percent decline y o y. AMT issuance was \$0.8 billion, a decline of 79.7 percent q-o-q and 66.3 percent y-o-y.

By use of proceeds, primary and secondary education led issuance totals in 1Q'16 (\$24.6 billion), followed by general purpose (\$24.4 billion), and higher education (\$10.4 billion).

Notable sectors that saw increased y-o-y issuance were water and sewer facilities (\$10.2 billion, an increase of 20.0 percent and 7.9 percent q-o-q and y-o-y, respectively) and economic development (\$2.3 billion, an increase of 3.8 percent and 26.3 percent q-o-q and y-o-y respectively).

Refunding volumes as a percentage of issuance rose slightly from the prior quarter, with 51.5 percent of issuance attributable to refundings compared to 43.6 percent in 4Q'15, but was a decline compared to the 62.2 percent in 1Q'15.

[Read the full report.](#)

May 18, 2016

Long-Term U.S. Muni Bond Yields Hit Another Low.

Long-term U.S. municipal bond prices rose again on Thursday, driving the 30-year yield down 1 basis point to a record low of 2.44 percent, with even some lower-quality deals selling at tighter spreads.

"There appears to be copious amounts of cash around" and "spreads are compressing as investors reach for yield," said Greg Saulnier, a Municipal Market Data (MMD) analyst. Bond prices move inversely to yields.

Previous record lows, set in November 2012, were 2.47 percent for the 30-year and 1.47 percent for the 10-year. Top-rated long-term munis broke that record on Wednesday and again on Thursday, according to MMD, a Thomson Reuters company.

Though the 10-year yield for triple-A munis rose 1 basis point on Thursday, it still closed just 7 basis points off the record at 1.54 percent.

Investors have poured money into muni bond funds for 32 weeks straight, with \$22.1 billion of inflows this year, according to data from Lipper, a Thomson Reuters unit.

The week ended May 11 was the biggest in inflows so far this year, with \$1.2 billion.

"This streak is quite amazing given the low levels of municipal rates and ratios, but the risk-adjusted yields on munis are still reasonable given the alternatives," said Chris Mauro, head of U.S. municipals strategy at RBC Capital Markets.

He will be watching whether bondholders put their money back into the market after their June 1 coupon payments.

"If recent weekly flows are any indicator, the reinvestment could be quite strong," he said.

Flows into long-term funds have also been near record levels as investors extend duration in an effort to pick up yield, Mauro said.

The last week in April, long-term muni funds had \$1.1 billion of inflows, their strongest showing since February 1997.

Investor demand for any yield at all in a global low-yield environment even squeezed spreads on lower credit deals.

On Thursday, the Central Texas Regional Mobility Authority received \$2 billion of orders for its \$368.7 million offering, making it more than five times oversubscribed, according to MMD.

But a spokesman for Central Texas told Reuters on Friday that the deal got \$4.2 billion of orders, meaning it was more than 11 times oversubscribed.

The authority's senior lien revenue refunding bonds were rated Baa2 by Moody's Investors Service, a low investment grade rating.

The demand allowed Central Texas to bump prices on its entire deal. The yield of bonds maturing in 2046 with a 5 percent coupon fell 13 basis points to 3 percent.

Reuters

By Hilary Russ

Fri May 13, 2016 4:08pm EDT

(Reporting by Hilary Russ in New York; Editing by Alan Crosby and Matthew Lewis)

U.S. Muni Bonds Unlikely Home For the Huddled Masses.

Could the almost 6m daily passengers on New York's subway system prove the unlikely beneficiaries of the ever growing universe of negative-yielding bonds?

It is not as far fetched as it sounds. Foreign investors are buying increasing amounts of the municipal bonds sold by US states and cities to fund public works and infrastructure projects.

The introduction of negative rate policies by the European Central Bank and the Bank of Japan, analysts and investors say, is further sharpening overseas interest in an asset class that historically has been the preserve of US buyers who are not required to pay tax on the income from municipal bonds.

"There is a real demand for yield," says Christopher Molumphy, chief investment officer of fixed-income at Franklin Templeton. "We've had some foreign buying into US municipals, which I was surprised about when I first heard because they don't benefit from the tax treatment."

Foreign investors still represent a tiny share of the \$3.7tn market. Foreign investors held \$85bn of the debt at the end of last year, up from \$80bn a year earlier and \$29bn in 2005, the latest data from the Federal Reserve show.

However, with almost \$10tn of bonds globally carrying negative yields, according to Fitch, and corporate bonds in the US and Europe rallying hard, many expect the buying to accelerate.

"We're probably in the first inning of the foreign investor game," argues Mikhail Foux, a specialist in municipal bonds at Barclays in New York. "We're seeing some money put to work but it is a small portion. Over the next six to 12 months we'll see more of that happening."

Fresh foreign buyers are helping to fan an existing rally in municipal bonds that has drawn impetus from a dearth of supply as US cities and states refrain from borrowing.

The yield on 10-year municipal bonds dipped below 1.7 per cent on Wednesday, less than one basis point above a record low touched this February as the asset class was buoyed by the sell-off in riskier assets. Bond yields move in the opposite direction to prices.

The benchmark ten-year US government bond yields 1.73 per cent, a result of the differing tax treatments. By contrast, similar German, French and Swedish sovereign debt offers less than 0.5 per cent, while shorter-dated bonds from the countries carry a negative yield.

Against a backdrop of wider market volatility — and still fragile sentiment towards riskier assets — muni bonds are continuing to lure US investors. Mutual funds and exchange traded funds that invest in municipal bonds have recorded 31 straight weeks of inflows, with \$19.5bn of fresh capital pouring in, Lipper data shows.

"Flows have been very heavy," says Mark Paris, who runs Invesco's high-yield municipal bond fund. "Supply . . . is now clearly down. The technicals are overwhelming. There have been deals that have been seven-times oversubscribed because so much money has come into the space."



It is a rally that has made munis expensive, according to Thomas McLoughlin, head of municipal research at UBS Wealth Management Americas, who cautions that interest from foreign buyers is

still nascent.

California and New York have been among the borrowers to benefit, with a \$1.4bn offering last month from the Golden State attracting “strong bids,” says Alan Schankel, a municipal bond analyst at Janney Montgomery Scott.



However, those high-profile sales stand out as activity has slowed. Sales this year, at \$138bn, are more than 10 per cent lower than the same period in 2015 as fewer issuers refinance, according to Thomson Reuters.

Then there is the politics. Despite an improved revenue picture at the state and local level the need to retrench during the financial crisis of 2008- 2009, when states suffered steep losses to their tax bases, has left a hangover.

“There’s a political stigma with taking on more debt,” says Genevieve Nolan, an analyst with Moody’s.

The looming presidential election is also diminishing the appeal of issuance to local and state politicians grappling with pension reforms, new healthcare programmes and — in states such as Alaska, Texas and Oklahoma — the drag on their finances from lower energy prices.

Natalie Cohen, head of municipal research at Wells Fargo, and Mr Foux of Barclays expect supply to climb after the election in November. Constitutional provisions in many states require voters to approve certain debt sales — most often concerning the issuance of general obligation bonds — a point that will be watched by underwriters as state and local elections near.

States and cities lack of appetite to tap the municipal bond market this year comes as the chronic lack of investment in America’s infrastructure climbs up the national agenda as a range of events, including a polluted water scandal in Flint, Michigan and problems with DC’s metro system, force attention on the issue. Presidential frontrunners Hillary Clinton and Donald Trump have called for investment in US infrastructure.

Investors are already casting their attention to potential funding for large projects, like the reconstruction of LaGuardia Airport and multibillion-dollar financing needs of New York’s transportation authority as it constructs its new Second Avenue subway.

If the trend continues, money escaping negative yields in the eurozone and Japan may ultimately help fund such ventures. As Ms Cohen of Wells Fargo says, “Even if [foreign investors] are not subject to the US tax code, a plus two is better than a minus one. It’s just basic math and that has made municipals attractive.”

The Financial Times

by Eric Platt in New York

May 12, 2016 5:23 pm

In the Lands of Negative Yields, Even U.S. Municipal Bonds Lure.

In 1989, Japanese investors bought Rockefeller Center. Now, they're plowing into the market that finances the subways underneath.

Faced with negative interest rates in their own countries, foreign banks and pension funds are looking increasingly toward municipal bonds, a bastion of buy-and-hold investors seeking U.S. income-tax breaks.

Money managers including ColumbiaThreadneedle Investments and Western Asset Management Co. say they have set up accounts for Asian and European investors who are buying U.S. state and local-government debt. In November, Shinsei Bank Ltd. and Western Asset, a unit of Baltimore-based Legg Mason Inc., started a private fund that invests in municipal bonds for Japanese financial institutions.

"We have investors coming from around the globe looking and saying, 'Here's a security that will offer us a decent yield without all the credit risk,'" said Robert Amodio, head of municipals in New York for Western Asset Management, which oversees about \$440 billion.

With central banks in Japan and Europe holding interest rates below zero in a bid to boost their moribund economies, overseas funds are contributing to the flood of money coming into the \$3.7 trillion municipal market where local governments borrow to build roads, bridges and schools. That's adding to a rally in the price of the bonds, whose low default rates and lack of volatility make them an alluring alternative to U.S. corporate debt.

Other assets have seen bigger price swings amid volatile oil prices and building concern about the slowdown of the Chinese economy. During a shift away from corporate junk bonds this year, for instance, the extra yield investors demanded to hold them instead of top-rated debt reached a more than four-year high of almost 9 percentage points in February. The gap has since narrowed by about 2.5 percentage points as prices recovered.

Since overseas firms don't benefit from the U.S. income-tax exemption given to interest payments from most municipal bonds, they've focused largely on the \$466 billion of taxable debt that carries higher yields. By Friday, those securities maturing in 10 years yielded 2.44 percent, 0.74 percentage point more than Treasuries. Similarly dated German bonds yield 0.14 percent, while in Japan they pay -0.11 percent, meaning it costs money to own them.

Taxable municipal bonds have outperformed over the 3, 5 and 10 years that ended Dec. 31, according to data from Barclays Plc. The bank's index of the securities had a total return of 6 percent per year over the past 10 years, compared with 4.5 percent for its broader measure of Treasuries, corporate debt and other U.S. investment-grade fixed-income instruments.

The international buyers are contributing to a flood of cash that has lifted municipal-debt prices and held yields near their lowest in half a century. Some of the investments have been made through mutual funds, said James Dearborn, head of tax-exempt securities at Boston-based ColumbiaThreadneedle, which has \$464 billion under management.

Municipal bonds are a haven from financial-market turmoil because more than half of it is owned by individuals typically more interested in the tax-free interest than capital gains. As a result, they tend to hold until maturity, preventing the periodic bouts of selling that whipsaw prices of other securities.

"They've been largely insulated from a lot of the volatility in the markets," said Dearborn.

International investors previously emerged as big buyers of Build America Bonds, which were created by the federal government to boost the economy after the onset of the recession. States and local governments issued almost \$200 billion of the taxable securities, whose interest payments were subsidized by the U.S. Treasury. By the time the program lapsed at the end of 2010, foreign investors held about \$72 billion of municipal debt, up \$21 billion from two years before, according to the Federal Reserve. By the end of 2015, they owned \$85 billion.

Bond-fund managers are cultivating the interest abroad. In March, Eaton Vance Management co-sponsored an institutional investors forum in Tokyo that drew more than a hundred representatives of banks, funds and pensions. Cindy Clemson, Eaton Vance's co-director of municipal investments, was among the speakers.

"Certainly in the Japanese climate, yield is at a premium," she said.

Shinsei and Western Asset last year started a yen-denominated fund, with about 8 billion yen (\$65 million) at the time, targeted towards revenue bonds, which finance projects such as toll roads, water and sewer systems or airports. The fund invests in those with an A rating, comfortably within investment grade, or higher.

"We've received a great response to our U.S. municipal bond funds," Akiko Suda, general manager of product planning at Tokyo-based Shinsei's asset-management business, said in an e-mail. "The funds are highly rated and spreads are comparatively deep. We have strong expectations for the investment balance to grow further here in Japan."

ColumbiaThreadneedle, a unit of Ameriprise Financial Inc., got its first mandate from foreign investors about a year ago, Dearborn said. The firm manages "hundreds of millions of dollars," in separate accounts or through its mutual funds, he said. ColumbiaThreadneedle is now seeing interest from Europe.

"This is a brand new thing for us," Dearborn said.

Bloomberg Business

by Martin Z Braun

May 16, 2016 — 2:00 AM PDT Updated on May 16, 2016 — 7:57 AM PDT

[S&P's Public Finance Podcast \(Local Government Insights and Credit Drivers, and the Rating Action on Kaiser Permanente\)](#)

In this week's edition, Senior Director Jane Ridley provides some insights on market ratings and drivers, in light of recent bankruptcies, and Managing Director Martin Arrick discusses our recent rating action on Kaiser.

[Listen to the Podcast.](#)

May 11, 2016

Hawkins Advisory (Area Median Gross Income Figures)

This issue of the Hawkins Advisory provides with information of specific interest to single-family housing bond issuers regarding area median gross income figures.

[Read the Advisory.](#)

Hawkins Delafield & Wood LLP

5/12/2016

What GFOA Members Need to Know About Bank Loans.

WASHINGTON - The Government Finance Officers Association posted an alert on Thursday encouraging its members to both voluntarily disclose the terms of their bank loans and pay attention to regulators' increased scrutiny of the lack of such disclosures.

GFOA gave its members several options for how to make the disclosures rather than suggesting one uniform method.

Bank loans have become popular in the municipal market with some issuers using them as an alternative to the issuance of munis because they are cheaper and subject to much less regulation.

While general information, such as the size of the loan, usually ends up in an issuer's annual financial reports, specific loan terms are only disclosed sporadically.

Many muni market participants, including the Municipal Securities Rulemaking Board, have urged the Securities and Exchange Commission to provide more guidance on bank loans, including when they could be considered a security and when municipal advisors working with issuers on them may be crossing over into broker-dealer activities.

GFOA told its members that they can make their disclosures in a variety of ways, including: posting loan agreements or a summary of their terms on the MSRB's EMMA website; incorporating bank loan information into their comprehensive audited financial reports; or releasing summaries of the loans' material terms on their own websites.

GFOA also warned members that if they use EMMA, they will have to be aware that the bank loan will not have a CUSIP and thus will have to be uploaded as "other information" connected with an already posted bond issue.

The MSRB recently said that it had conducted a search ending on March 28 that uncovered only 143 hits when searching EMMA for the term "bank loan." Of those hits, 64 were not filed in the recommended subcategory for bank loans.

The MSRB recommends issuers disclose bank loans under its continuing disclosure category of "financial/operating filing" and then "investment/debt/financial policy."

"Disclosure of a bank loan would be relevant to bondholders if the bank loan is secured by any or all of the same revenues as the outstanding bonds, and is large enough to be material to the

creditworthiness of the government,” GFOA said in the alert. Additionally, if a government executes numerous bank loans, the combination of those loans in the aggregate and the terms and conditions of the loans may be important for investors in the government’s bonds to know, the group said.

GFOA also advised members to develop policies and procedures that address applicable legal and financial requirements for using bank loans in their jurisdictions and to seek guidance from outside professionals like municipal advisors and bond counsel when reviewing the terms of bank loans.

Without that focus, regulators may feel the need to step in, GFOA warned.

“While disclosure of bank loans is not required under MSRB or SEC rules, issuers are advised that increased regulatory scrutiny may result in mandatory disclosure of bank loans in the future, subject to similar standards of materiality and timeliness as apply to municipal securities,” GFOA said.

The alert also focused on an MSRB concept release from March 28 that asked whether the self-regulator should require MAs to disclose information about the bank loans or privately placed munis of their issuer clients. The MSRB said it proposed requiring the disclosures from MAs because issuers have not readily responded to requests for voluntary bank loan disclosures on EMMA.

GFOA said it has significant concerns with the proposal, partly because municipal advisors are the only party in a municipal debt transaction that has a fiduciary responsibility to issuers.

“MSRB’s proposed approach to pass along responsibility of issuer disclosure of bank loans and private placements breaches that fiduciary duty, making MAs also beholden to the investor community,” GFOA said in the alert. “Such a requirement would change the nature of issuers’ relationships with MAs in a manner that is neither beneficial to issuers or MAs.”

The group did not explicitly ask members to file comments but provided them links to the proposal with a reminder that comments are due by May 27.

The Bond Buyer

By Jack Casey

May 12, 2016

[Chicago Water Bond Deal Washes Off Taint of Interest Rate Bets.](#)

Chicago removed the stain of ill-timed bets on derivatives as it sold more than half a billion dollars of debt for its water system.

The nation’s third-largest city sold about \$505 million of securities on Wednesday to buy back the last of its variable-rate debt and help cover about \$102 million of fees to Royal Bank of Canada and Barclays Plc to break off interest-rate swaps.

The offering concludes a refinancing wave by Chicago since its credit rating was cut to junk by Moody’s Investors Service a year ago, which gave banks the right to force it to pay off debt early and terminate related swap contracts. Chicago has already paid about \$260 million to cancel derivative trades over the past 12 months, foisting added costs on a city already contending with soaring bills to a retirement system that it owes \$20 billion.

"It's a smart defensive move to do this, and I think the market will view it positively," said Paul Mansour, head of municipal research at Conning, which oversees \$11 billion of state and local debt, including Chicago securities, and is considering buying in the latest deal. "It represents good financial stewardship to remove derivative products from the balance sheet as it reduces financial risk."

Securities due in 2031 sold for 3.08 percent, according to three people with knowledge of the deal who requested anonymity before the final prices were released. The top yield is about 1.1 percentage points more than benchmark municipal debt that matures in 15 years, data compiled by Bloomberg show.

"Investors responded quickly and favorably to the second lien water revenue bonds demonstrating the financial community's ongoing support for the Mayor's plan to repair city finances," Carole Brown, Chicago's chief financial officer, said in an e-mailed statement after the sale.

Even before the Moody's downgrade, Mayor Rahm Emanuel had been planning to cut the city's exposure to floating-rate bonds and derivatives, a financing technique that was popular with states and cities until the financial crisis of 2008 hit them with spiraling bills. Such deals have since cost governments billions and helped to push Jefferson County, Alabama, into a record-setting bankruptcy.

Chicago has sold about \$2.8 billion of debt in the past 12 months, according to Bloomberg data. It last issued \$500 million of tax-exempt general-obligation bonds in January for top yields of 4.9 percent, about 2.3 percentage points more than benchmark securities.

The city's latest may benefit from an influx of cash into municipal-bond funds that are hunting for higher returns as yields hover near a 50-year low. Investors added \$710 million to such funds in the week ended May 4, marking 31 weeks of inflows, according to Lipper US Fund Flows data.

Chicago's water bonds carry higher credit ratings than its other securities, thanks to the revenue reaped from rate increases in the past three years and a customer base split between the city and its suburbs. S&P Global Ratings on April 26 boosted the second-lien water bonds to A, five levels above junk and two steps higher than the city's general-obligation debt, citing the benefits from getting rid of the derivative deals. Moody's, which didn't rate Wednesday's deal, grades Chicago's second-lien water debt Baa2, two steps above junk.

Beyond Names

"It has the name Chicago in it so some investors look at it kind of negatively, but if you look at the underlying credit it's a strong credit," said Brian Steeves, a portfolio manager in Rye Brook, New York, at Belle Haven Investments, which oversees \$4 billion of munis and is considering buying the new bonds. "It will definitely be well-subscribed."

In a sign of such demand, the water-system debt trades for lower yields than the city's general obligations, indicating that investors perceive less risk. A portion of the securities due in 2025 traded Tuesday for an average yield of 3.3 percent, according to data compiled by Bloomberg. That compares with 5.1 percent for general obligations.

Even so, Chicago's still struggling with ballooning retirement costs and the political paralysis that's left the state without a budget.

"There still is that broader cloud of the pension and the lack of a state budget that overshadow some of these positive fundamental trends for some of the specific issuers in the Chicagoland complex,"

said Gabe Diederich, a Menomonee Falls, Wisconsin-based portfolio manager at Wells Fargo Asset Management, which manages about \$39 billion of munis, including various Chicago bonds.

Emanuel has yet to lay out how Chicago will shore up its pension funds after the state supreme court threw out his plan to reduce benefits and require workers and the city to boost their contributions. A record property-tax hike will provide funds for the police and fire pensions, but without changes, the other two retirement funds will run out of money in 10 to 13 years.

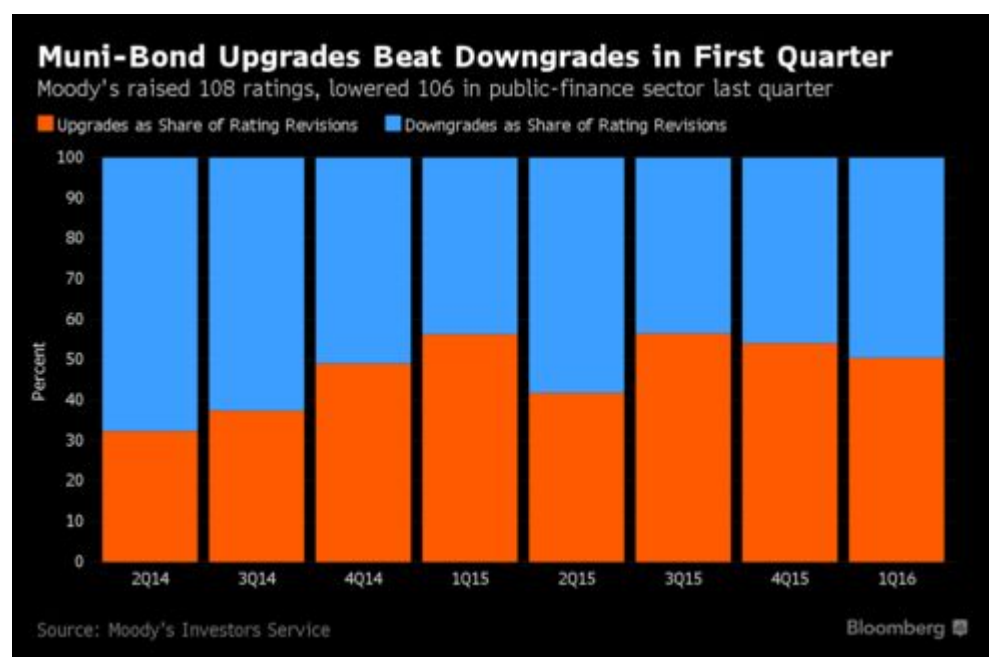
“Once you have a distressed obligor, in this case, the city, it’s best to just avoid everything given the uncertainty of just what tools it’ll use to kind of repair its own general operating budget,” said Tom Schuette, co-head of credit research and portfolio management at Solana Beach, California-based Gurtin Fixed Income Management LLC, which doesn’t hold Chicago debt among its \$10.1 billion of assets. “Once you’re in a distressed situation, we think all bets are off.”

Bloomberg Business

by Elizabeth Campbell

May 11, 2016 — 2:00 AM PDT Updated on May 11, 2016 — 2:51 PM PDT

[Oil Industry's Rout Slows Pace of Municipal-Bond Upgrades: Chart](#)



Moody's Investors Service raised slightly more U.S. municipal-bond ratings than it lowered in the first three months of 2016, marking the fourth time in five quarters that upgrades have exceeded downgrades. Moody's raised the ratings on 108 borrowers and lowered the rankings of 106, the company said in a report Tuesday. Low oil prices helped to drive the downgrades, which included energy-industry dependent Alaska, Louisiana and Houston.

Bloomberg Business

by Elizabeth Campbell

May 10, 2016

Municipal Market is 'Wild West' for Green Bonds, TIAA Says.

The \$3.7 trillion municipal market is the “wild, wild West” for so-called green bonds as issuance of such deals ramps up despite no industry-standard criteria for the securities, according to Joel Levy, group head of municipal fixed income at TIAA Global Asset Management.

There is no settled classification for what constitutes a green bond, according to Levy, who moderated a panel on sustainable investing at the National Federation of Municipal Analysts conference in Chicago on Thursday. In some ways, the label is a marketing tool, said Glen Yelton, vice president and head of impact research at SNW Asset Management, who called for an external standard to use as a benchmark.

“There are more green bonds,” said Levy, who oversees about \$350 million of the firm’s \$11 billion of municipal debt. “There will be more green bonds labeled this year than there were last year, and next year, there’ll be more than this year.”

U.S. state and local governments have issued about \$7.5 billion of green bonds since 2010, according to data compiled by Bloomberg. The designation is being used by borrowers to appeal to buyers who use social factors such as the environment, education and health care to guide their decisions.

“Because this asset type is relatively new and without industry accepted standards, investors who are interested in green bonds may want to rely on the expertise of asset managers that have the resources and knowledge to carefully evaluate the validity of the social and environmental impact of these issues,” Levy said in a follow-up e-mail on Thursday. Individual investors can use TIAA-CREF’s social choice bond fund to invest in green bonds.

Certification Providers

Green bond issuance globally, not just counting municipal debt, reached \$16.5 billion in the first quarter of this year after totaling \$42 billion last year, according to Yelton, who cited data from Climate Bonds Initiative.

Some companies and organizations such as Sustainalytics, an Amsterdam-based firm, offer certification. New York’s Metropolitan Transportation Authority sought in February to have an offering certified under standards set by the Climate Bonds Initiative, the agency’s first green-bond issue.

A green bond is a label that is “self-declared by the issuer,” said Thomas Kloc, managing director of the U.S. sustainability services practice at KPMG. It’s important that there’s some accountability and measurable metrics on what the green project is going to do going forward, he said. The issuer should be providing “enough transparency” so investors are able to decide if the bond meets their definition of green, Kloc said.

Bloomberg Business

by Elizabeth Campbell

Municipal Bond Premiums: Separating Fact from Fiction.

SUMMARY

- Investors may prefer premium municipal bonds once they separate fact from fiction.
- Yield to worst is a more meaningful metric than price to help determine value.
- A premium helps defend against punitive tax consequences of the IRS de minimis rule.
- Understanding premiums on municipal bonds can be confusing for many investors. Common misconceptions regarding premiums can prevent investors from making sound investing decisions in the municipal bond market.

Unfortunately, when it comes to premium municipal bonds, we often hear these fictions repeated:

- “If I buy a premium bond and it matures at par, I lose that premium. I will lose money, so I should avoid premium bonds.”
- “My muni bond, which yields 2% and pays a 5% coupon, provides me with income of 5%.”
- “If I buy a bond at \$110 and it matures at par (\$100), I get to book a \$10 loss.”

The concept of “lost premium” is a fiction. In this Insight, we present facts about premium municipal bonds in order to help dispel common misconceptions. We explain why most municipal issuance comes as a premium, how the coupon factors into the equation, why the yield to worst (YTW) is so important to consider, and how the investor can opt to preserve the premium paid on a municipal investment.

Fact #1: The size of a bond’s premium is not an indication of value.

Put differently, a premium bond is not inherently an overvalued bond. Historically, the size of a bond’s premium is directly related to the bond’s coupon – the higher the coupon, the higher the premium. This is best explained by comparing two bonds and their associated cash flows.

Consider two bonds that both mature in one year, shown in Exhibit A. Both bonds have a YTW of 3%; YTW is a measure of what investors earn on their money, expressed as an annual rate. Which bond do you prefer, and why?

At maturity in one year, the cash flows associated with each bond tell us the real story. Netting the coupon income against the amortized premium is how the investor determines the true income (or yield income) of a municipal bond. Both scenarios assume the buyer receives \$100 par back at maturity; both bonds provide a return of 3% despite one having a premium and one not having a premium.

Importantly, there is no loss on either bond; this dispels one of the most oft-repeated fictions about premium municipal bonds. The premium on Bond 2 is amortized down and is returned in the form of a higher coupon; it is not being lost.

Exhibit A Cash flows tells the real story with premium muni bonds.

Bond 1 (Par Bond)						
Yield	3%	Coupon Income	\$3	-	Amortized Premium	\$0 = Yield Income \$3
Coupon	3%					
Initial Cost	\$100					
Premium Paid	\$0					
Bond 2 (Premium Bond)						
Yield	3%	Coupon Income	\$5	-	Amortized Premium	\$2 = Yield Income \$3
Coupon	5%					
Initial Cost	\$102					
Premium Paid	\$2					

Source: Eaton Vance. This chart is for illustrative purposes only. Results may not represent the experience of individual investors, and should not be construed as tax or legal advice. An investor should consult a financial and/or tax professional concerning his or her specific situation before making any financial decisions. Any references to future returns should not be construed as an estimate of the results a client portfolio may achieve.

W

orst is the best determinant of value for premium municipal bonds.

The price of a premium bond is certainly relevant, but it must be viewed in the context of the bond's other characteristics, such as the coupon rate, call and put provisions, time to maturity and YTW, as well as other factors such as credit structure and the availability of alternatives offering similar income potential.

Many investors confuse coupon and yield (more precisely, yield to worst or YTW). Yield is defined as what you earn on your money. As outlined above, when you net the annual coupon income against the amortized premium, the net result is the yield income of the bond. This is the math behind municipal bonds and it always holds true.

Yield, therefore, is a more meaningful metric than price to help investors to determine the value of a particular bond issue, and YTW factors in the possibility of a bond issue potentially being called or subjected to default or other provisions.

The fact that investors receive 1099-INTs with only the coupon income can be misleading. Investors must determine the bond price amortization (mistakenly thought of as lost premium) for the year and subtract that from the coupon income for their tax filings. The bond amortization schedule is readily available. It is this net number (coupon income minus bond amortization) that must be reported on the investor's annual tax return.

Fact #3: Municipal bonds issued with a premium guard against tax consequences of de minimis risk.

Bonds are issued with premiums in the municipal market to guard against a taxable event resulting from the IRS de minimis rule. Only issuers can create tax-exempt income. When market conditions dictate that a bond should sell at a discount, accretion from the discounted price may represent income taxed as ordinary income instead of capital gains. Per the IRS, a discount (from the lower of par or an accreted original issue discount) equal to 0.25% times the number of full years to maturity is considered inconsequential (or de minimis). Once the discount exceeds this threshold however, all accretion is taxable as ordinary income.

Here, an example might help better explain the concept. Take a bond with a 20-year final maturity

issued at \$100, but purchased in the secondary below \$95. As the bond accretes or gains value (it will mature at \$100, or par), the accretion is subject to being taxed as ordinary income.

It is because of this IRS rule that investors in the muni bond market demand high premiums, also known as coupon protection. A stated coupon in excess of the YTW of a bond means its price will be at a premium, offering some protection against potential higher taxes.

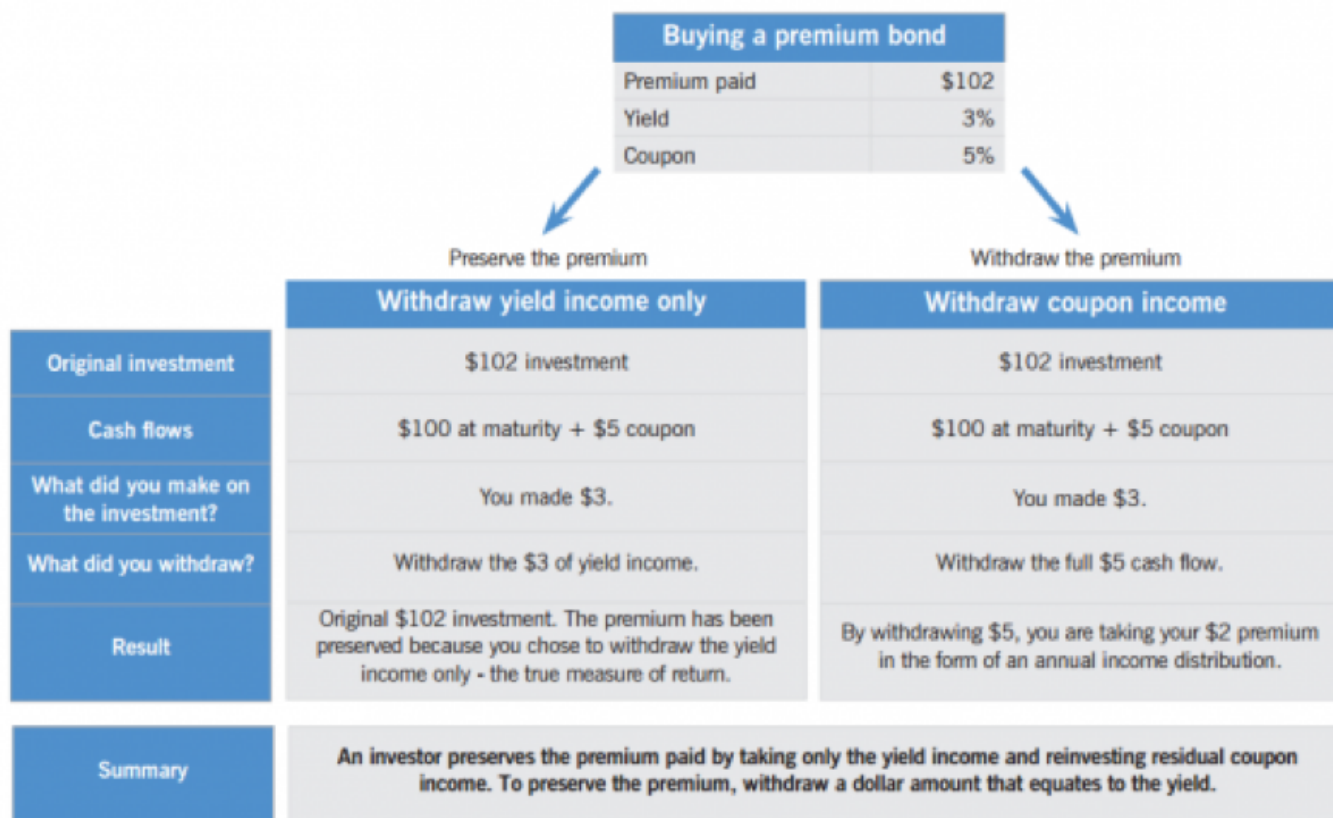
We note that in 2015, roughly 75% of bonds issued in the market had 5% or greater coupons with significant price premiums. In addition, the publicly disclosed muni trade history on the website of the Municipal Securities Rulemaking Board (MSRB) shows a large majority of trades with prices of \$115 and higher, indicating the prevalence of bonds offering coupon protection.

Fact #4: An investor can preserve the premium of a bond by only receiving yield income instead of the full coupon income.

As discussed, municipal bonds are issued at premium prices to guard against taxes. The higher the premium, the higher the coupon rate on the bond. But as also discussed, the true measure of bond return is only the yield, not the coupon. It is important to realize that taking an income distribution in excess of the yield means you are eroding the principal of your muni bond investment. If a bond yields 3% and the coupon rate is 5%, receiving a distribution of 3% preserves the premium paid, while receiving a distribution of 5% erodes the premium. A premium bond amortizes some of its premium every year, reducing the cost basis until the bond matures at par. This amortizing premium is directly offset by the coupon income in excess of the yield. An investor wishing to preserve the premium paid can opt to take only the income corresponding to the yield, or yield income, and, in doing so, preserve the original premium paid.

Consider a premium bond with one year to maturity, a coupon of 5% and a yield of 3% purchased at a premium price of \$102. In the first case, the investor chooses to receive the full coupon income of 5% as a distribution, as shown in Exhibit B.

Exhibit B **How an investor could preserve the premium paid on a premium muni bond.**



Source: Eaton Vance. This chart is for illustrative purposes only. Results may not represent the experience of individual investors, and should not be construed as tax or legal advice. An investor should consult a financial and/or tax professional.

Alternatively, if the investor had instead chosen to take a distribution of only the yield income of 3% (the true measure of return), residual coupon income of 2% would have been realized. (You can determine the excess coupon income by subtracting the yield from coupon. In this case, it's 5% - 3% = 2%) By taking only the yield income and reinvesting the residual coupon income, the investor preserves the premium paid.

Why we favor premium bonds

Investors tend to prefer premium municipal bonds once they separate fact from fiction. Fortunately, the facts are easy to understand:

- The size of a bond's premium has nothing to do with the bond's value.
- Yield is the meaningful metric - not price - to help determine the true return.
- Premiums help defend against punitive tax consequences of the de minimis rule.
- An investor can preserve a premium paid by taking only yield income.

For savvy investors, premium bonds can be an appropriate vehicle for building a muni bond portfolio with a defensive structure in today's low-yield environment. All else equal, a premium bond (higher coupon) will likely outperform a par bond in a rising rate environment thanks to a lower duration, or sensitivity to interest rates.

Relying on YTW is just one of the many factors to consider when purchasing premium bonds. We believe security selection will be critical to success when investing in a market as vast and increasingly complex as the municipal bond market. We believe relative value analysis is just as important. As always, individual investors may benefit from skilled professional management and

credit research.

Importance tax considerations

Many investors are not aware of IRS guidelines on reporting tax-exempt investment income, which instruct investors to report on line 8b of the 1040. This is not the 1099-INT income, but rather the income less the annual reduction (or, more accurately, the amortization) of bond premium.

Though provided by the advisor's firm, investors can calculate the premium amortization (or reduction of premium) themselves. The IRS instructs investors to use the current yield method of amortizing bond premium.

About Risk

An imbalance in supply and demand in the municipal market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. There generally is limited public information about municipal issuers. As interest rates rise, the value of certain income investments is likely to decline. Longer-term bonds typically are more sensitive to interest-rate changes than shorter-term bonds. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. A portion of municipal bond income may be subject to alternative minimum tax. Income may be subject to state and local tax.

The views expressed in this Insight are those of the authors and are current only through the date stated at the top of this page. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance fund. Eaton Vance does not provide legal or tax advice. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness. Individuals should consult their own legal and tax counsel as to matters discussed.

Before investing, investors should consider carefully the investment objectives, risks, charges and expenses of a mutual fund. This and other important information is contained in the prospectus and summary prospectus, which can be obtained from a financial advisor. Prospective investors should read the prospectus carefully before investing.

May 2, 2016

by Jonathan Rocafort, Christopher Harshman, Evan Rourke
of Eaton Vance

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[MSRB Publishes First Quarter 2016 Municipal Market Statistics.](#)

The Municipal Securities Rulemaking Board (MSRB) today released municipal market statistics for

the first quarter of 2016, showing par amount traded rebounded to \$634.7 billion, up from \$507.3 billion traded in fourth quarter 2015 and slightly higher than the \$618.5 billion traded during the first quarter one year ago. The MSRB's quarterly statistical summaries include aggregate market information for different types of municipal issues and trades, and the number of interest rate resets for variable rate demand obligations and auction rate securities.

[View the 2016:Q1 statistics.](#)

[Cities Go After Lenders.](#)

The foreclosure crisis certainly hurt the millions of homeowners who lost their houses during the Great Recession. But it hurt localities, too. They lost tax revenue. And in a case of cause and effect, they watched as the suddenly vacant houses led to blight, which in turn led to spikes in crime because governments at the time couldn't afford to invest more in their police forces.

So now cities are testing whether they can sue banks for damages under the Fair Housing Act. Los Angeles; Miami; Oakland, Calif.; and Providence, R.I.; have all filed lawsuits against lenders seeking reparations. The lenders are arguing that the act applies to people, not governments. The question of whether cities have the standing to sue is before the U.S. Supreme Court.

The takeaway: If the court rules that cities don't have standing to sue, it would add to the view that financial institutions are not being held accountable for their role in the 2008 crisis. [As The Atlantic noted this week](#), the people who were most damaged by the foreclosure crisis — those who lost their homes — typically don't have the resources to bring lawsuits. Most of the civil suits have been brought by investors who bought bad home loans. In their quest, cities likely represent the last group to try to punish lenders for their practices during the mid-2000s.

GOVERNING.COM

BY LIZ FARMER | MAY 6, 2016

[S&P's 2015 Annual U.S. Public Finance Default Study and Rating Transitions.](#)

U.S. public finance (USPF) exhibited growing credit strength in 2015, though at a slower rate than in 2014. Overall, upgrades outpaced downgrades by a ratio of 2.20 to 1 in 2015, compared with 3.33 to 1 the previous year. The ratio of upgrades to downgrades was 2.15 to 1 for bonds excluding housing and 4.27 to 1 for housing bonds. In the previous year, the ratio for nonhousing was 3.38 to 1, and housing had more downgrades than upgrades.

In addition, in 2015, upgrades outnumbered downgrades in every quarter for the third consecutive year. The year ended with 13 straight quarters of more upgrades than downgrades, the longest streak since the first quarter of 2001. In the midst of this, defaults increased to 12 in 2015 from eight in 2014. This continues a recent phenomenon of higher-than-average defaults, particularly among appropriation-backed debt. In the last five years, the number of defaults among credits not including housing has exceeded the average of three going back to 1986. There were 21 defaults of appropriation debt between 2011 and 2015, after only three in the previous 25 years.

Overview

- S&P Global Ratings upgraded 991 bonds and downgraded 461 in USPF in 2015, excluding housing.
- There were 47 housing upgrades and 11 downgrades in 2015.
- All but one sector in USPF—higher education—had more upgrades than downgrades in 2015. This was the second consecutive year of negative rating trends in higher education.
- Twelve defaults occurred in USPF in 2015, compared with eight the previous year.
- Since 1986, the average annual number of defaults in all of USPF combined is five, out of a total of more than 21,000 ratings.

[Continue reading.](#)

04-May-2016

GASB Forms Going Concern Disclosures Consultative Group.

The GASB has formed a consultative group to assist the Board's research in the reexamination of the going concern provisions of [Statement No. 56](#), *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. The members were appointed by GASB Chair David A. Vaudt.

High-Yield Funds With Cash to Burn Chase Tobacco Bonds' 51% Gain.

High-yield municipal bond fund managers have cash to burn. So do American smokers, who have extra money after filling their gas tanks.

The two groups, each in their own way, are driving a rally in the \$34 billion tobacco-bond market that's outpacing just about every other investment.

High-yield tobacco securities have surged 10.2 percent in 2016, the most among all segments of the \$3.7 trillion municipal market, Barclays Plc data show. That follows gains of 15.8 percent and 19.2 percent in the past two years. The 51 percent return since the start of 2014 beats more than 80 percent of stocks in the S&P 500 Index and close to 90 percent of the Russell 2000 Index of small-cap company shares, data compiled by Bloomberg show.

To explain much of the gain, one needs only to follow the money. Individuals added cash to high-yield muni funds for 100 of the past 122 weeks, lifting their assets to a record \$82 billion from \$58 billion at the start of 2014, according to data from Morningstar Inc. and Lipper US Fund Flows. With Puerto Rico heading toward an unprecedented restructuring, money managers who once snapped up the island's bonds are now avoiding them, leaving the tobacco securities one of the few available alternatives.

The other side of the rally stems from signs that American smokers are using savings at the gas pump to buy more cigarettes. The shipments backing the debt as part of a 1998 settlement with tobacco companies increased last year by 1.9 percent, the most ever, according to data from the National Association of Attorneys General.

"If you're getting lots of money into a high-yield fund and you've decided that you're not going to buy Puerto Rico, like most people, really tobacco is your only other option," said Craig Brandon, co-director of municipal investments in Boston at Eaton Vance Management, which oversees \$32.5 billion of the debt. The uptick in smoking "gives you a credit reason to buy tobacco at a time when you really need a high-yield sector to invest in."

Buying tobacco bonds has long been considered a risky move. Most are rated junk because when governments first sold them more than a decade ago, which gave them advances on money they are set to receive from Reynolds American Inc., Lorillard Inc. and Philip Morris USA, they didn't anticipate how quickly Americans would give up smoking. And the more cigarette sales fall, the longer it will take for governments to collect the payouts.

Moody's Investors Service projects that a 4 percent annual decline in cigarette shipments would cause 80 percent of the bonds to default. From 2007 to 2014, the drop was even bigger: Shipments fell an average of 4.7 percent annually, according to NAAG data.

The decline in oil prices in the second half of 2014 — from over \$100 a barrel to about \$53 — halted the decline because gasoline fell, too, giving people more disposable income. The national average for a gallon of gas in the U.S. is \$2.22, about 40 cents lower than a year ago, according to the American Automobile Association.

Smokers "save more because of lower gas prices and they tend to spend it on cigarettes," said Vikram Rai, head of muni strategy at Citigroup Inc. While the boost in cigarette shipments "could be a flash in the pan," he says high-yield investors should consider buying the securities and definitely hold onto those they currently own.

Some of the biggest and most-frequently traded tobacco bonds are at levels not seen since before the financial crisis.

Two of the three largest single tobacco bonds, from Ohio's Buckeye Tobacco Settlement Financing Authority and California's Golden State Tobacco Securitization Corp., traded in the past two weeks at about 100 cents on the dollar, the most since February 2008 and August 2007, respectively, data compiled by Bloomberg show. Both have a June 2047 maturity and ratings six steps below investment grade by Moody's, which projects annual shipment declines of 3 percent would cause them each to default.

"I'm pretty cautious at these levels — there's been a lot of gains," said Alan Schankel, a managing director in Philadelphia at Janney Montgomery Scott. "The upside is limited as you approach par, and the downside is there."

Tobacco-bond returns have also dwarfed other junk asset classes. High-yield corporate bonds and loans returned 4.75 percent since the start of 2014, Barclays data show.

While buying after the rally isn't the best entry point, the dynamics driving it don't seem likely to change this year, Citigroup's Rai said. Even if prices remain steady, the largest tobacco bonds offer investors yields above 5 percent at a time when top-rated munis maturing in 30 years deliver half as much.

"Tobacco bonds are priced properly because we know what the moving parts are; we know how to model that risk," Rai said. "If you're content with a 6 or 7 percent return, even if you buy them now, you'll get that."

Bloomberg Business

Measuring Municipal Bond Market Liquidity.

We reviewed trade and quote activity on approximately 570,000 unique municipal bonds from January 2015 through March 2016. The study surveyed the overall quote/trade depth and diversity during that period, as we focused mainly on unique bonds during various periods of time. This study did not factor in trade, quote, or bond issue size, but we want to make it clear that all three can also be used to assess a bond's liquidity profile. We note that since the dataset includes quotes and trades regardless of size, it could potentially overstate liquidity as compared to a round lot portfolio.

Our analysis concluded that municipal bond liquidity was stable during the period and the market was relatively efficient, but there were intermittent periods when liquidity did taper off due to seasonal factors. Here are some of our findings:

- 483,647 unique bonds traded and 253,194 were quoted in 2015, with approximately 50% of those appearing in the first four months of the year. Almost 99% of the quoted bonds traded at least once, with approximately 2,800 never trading during the year

- There is a direct relationship between the number of unique quotes and bonds that trade on a given day or month, with the correlation almost perfectly linear during a monthly period. The difference likely illustrates some time delay between the negotiation initiated post-quote and when a trade actually takes place

- The number of dealers quoting a bond on a given day is correlated with the likelihood of it trading. Data indicates that increasing the depth from one to four dealers increases the probability of a revenue bond trading from 19% to 66%, based on 2015 data

- New York general purpose and public improvement bonds had the highest likelihood of trading (25%) in 2015 among the 15 most quoted and traded use of proceeds and state combinations revenue bonds that were only quoted once on a given day. In the case of general obligation bonds, Massachusetts bonds had the highest trade rate (22%) based on the same analysis

- There were 250 trading days in 2015 and not a single municipal bond traded every day. However, there were two bonds that traded 248 days: California State 7.55% 4/2039 and Illinois State 5.1% 6/2033 taxable bonds, with neither making the top 10 list of most traded bonds in 2015 by trade count

- Approximately 9,900 bonds traded at least 10 days in 2015, but quotes were not sent via a broad distribution by any dealers during the year. However, there were only 316 bonds that were quoted at least 10 days that never traded during the year

[Download the full Report.](#)

markit

Chris Fenske | Director, Head of Fixed Income Pricing Research

Move over, Puerto Rico, Illinois, New Jersey and Other States Face Municipal Bond Woes, Too

Puerto Rico isn't the only municipal bond issuer facing fiscal problems, and if your clients are expecting a smooth ride in the high-yield muni market, you may have to tell them to fasten their seat belts.

Puerto Rico's partial default on its bonds this month shook the muni market, and particularly some funds with big holdings in the bonds, which are free from state and local taxes across the country. But other muni issuers are in rough shape as well, even though most states' balance sheets are improving, says Standard & Poor's.

The two biggest problems: Falling oil prices and exceptionally brutal financial wrangling in the statehouses. States that depend on oil production, such as Alaska, Louisiana, Oklahoma and North Dakota, are seeing revenue shortfalls because of lower energy prices.

Alaska, for example, is facing a \$3.9 billion budget shortfall, equal to 74% of expenditures, according to S&P. It's rated AA+, a strong rating, but with a negative outlook. Louisiana, which is not only dependent on oil, but has major structural budget problems, is rated AA with a negative outlook.

Many of the states' woes appear to be of their own making. Illinois, for example, has an A- rating with a negative outlook, the worst of the 50 states. The rating could hit BBB if the state does not make "significant improvements to its budgetary alignment," S&P said in its most recent assessment of the state's debt.

New Jersey boasts the next-worst rating for its general obligation bonds: an A rating, with a negative outlook. The state's underfunded pensions and large outstanding debt were behind the relatively low rating.

Even though states can't declare bankruptcy, their bond prices can get smacked when they get a ratings downgrade. Nevertheless, some funds have taken significant stakes in Illinois and New Jersey debt, according to Morningstar, the Chicago investment trackers.

Prudential Short Duration Muni High Income (PDSAX) has 11.9% of its assets in New Jersey paper, according to Morningstar, the highest percentage of any fund in the high-yield muni category. (It also has 11.2% of its portfolio in Illinois).

The biggest fan of Illinois muni bonds: Wells Fargo High Yield Municipal A (WHYMX), with 15.2% of its assets in the state's paper. Oppenheimer Rochester Limited Term Muni (OPTIX) has 12.9% of its portfolio in Illinois munis, as well as 19.7% in Puerto Rico.

Most of these funds have relatively low duration, which means that they're not taking any chances on long-dated issues from shaky states. Prudential's offering, for example, has an average effective duration of 3.85 years. The Wells Fargo fund weighs in at 5.67 years.

States with rising populations have the best outlook for their municipal finances, S&P says. Those states with an aging population are spending more on retirement benefits and less on infrastructure,

which could limit future growth.

Investing in municipal debt with shaky credit ratings is far less dangerous than it may seem, at least in the long term. High-yield municipal bonds funds have returned an average 7.4% a year the past five years, vs. 4% for high-yield corporate bonds. And funds that invest in long-term California bonds — once a poster child for state budget reform — have returned an average 6.9%.

Investment News

By John Waggoner

May 6, 2016 @ 1:04 pm

[S&P Public Finance Podcast \(State Budgets And Oyster Bay, New York\)](#)

In this week's episode, Managing Director Gabe Petek discusses the highlights of our comprehensive report on state budgets and credit analyst Victor Medeiros explains what spurred our recent rating action on Oyster Bay, New York.

[Listen to the podcast.](#)

May 3, 2016

[Why Consolidations in Municipal Evaluations Landscape Signal 'Tectonic Shift' for Industry.](#)

A string of recent acquisitions in the municipal pricing and indexes space could bring “colossal change” to the market, participants said.

It began last October, when Intercontinental Exchange announced the purchase of Interactive Data Corp. for \$5.2 billion. Then, in March, ICE announced the acquisition of Standard & Poor's Securities Evaluations and Credit Market Analysis. Additionally, Bloomberg purchased Barclays' Risk Analytics and Index Solutions business. The BRAIS are currently evaluated by IDC.

Stephen Winterstein, managing director of research & chief strategist at Wilmington Trust Investment Advisors, Inc., thinks it's unlikely these acquisitions in such a short span are pure coincidence.

“How it shakes out is anyone's guess. This appears to be the start of a game of musical chairs,” said Winterstein. “There were five major valuation services for municipal securities. Perhaps we are seeing only the beginning of a consolidation in that segment's service providers.”

Winterstein noted there are currently three leaders in municipal fixed income indexing: Barclays (soon to be Bloomberg), S&P, and Bank America Merrill Lynch. He also said he could imagine a world where ICE is in both the municipal bond evaluation and index businesses.

“In light of their recent acquisitions, I wouldn't be at all surprised to learn that ICE is developing its own family of fixed income indices, or planning to possibly acquire another index group – or, perhaps

a combination of the two," he said. "Further, the acquisition of IDC and S&P Evaluations may pave the way for ICE to create a municipal electronic exchange. After all, they are in the business of securities exchanges, so they certainly have the bandwidth, and now they have the data content to undertake such a challenge in the municipal bond market."

There are more questions than answers on this topic but Winterstein said he firmly believes that this is going to be a "colossal change" and that no one knows what the end result will look like.

"I think there is a tectonic shift afoot in how munis will be evaluated and what index families will thrive," he said. "Over the next six to eighteen months this could be a bigger deal than anyone is making it out to be now.

"What were the two leaders in municipal evaluations are now in the process of becoming one," Winterstein said. "There are barriers to enter this niche marketplace and it's a space that saw few players to begin with. It is a rapidly occurring confluence of transactions and circumstances within the municipal fixed income markets, over which many practitioners are scratching their heads."

Tom Doe, president of Municipal Market Analytics in Concord, Mass., said the arrival of Wall Street giant Intercontinental Exchange Inc. into the municipal market is monumental and could have a serious lasting impact on the industry.

"I find this as potentially disruptive as when the futures markets went from an outcry of people on the floor to an electronic exchange," Doe said. "That changed the data and the personality of the market."

ICE owns the New York Stock Exchange and is the leading network of regulated exchanges and clearinghouses for financial and commodity markets.

Creating a pricing service monopoly has its potential advantages and disadvantages, according to Doe, whose firm is a leading source of municipal market analysis and commentary.

Chief among the "interesting" yet unanswered questions is price discovery, regulation, and how ICE will interface with the Municipal Securities Rulemaking Board, he said.

Kevin Strom, senior managing director and head of capital markets at Ziegler said that we have regulators and technology vendors who are driving hard towards a new world order, whatever that will eventually look like. On the other side, he said, there are broker dealers who are struggling to catch up on the technology and regulation front, and doing everything to control costs "while the vendors could increase costs and I assure you, the compliance and regulatory environment is raising everyone's costs.

"This is a bad recipe if you're on the dealer community side of the fence, so this is a big deal," he said.

"The words oligopoly and monopoly come to mind," Strom said. "My costs for pricing and data services are not going down in all likelihood, they are going up. If the Justice Department and regulators allow that to happen as it relates to bond markets where those two pricing services are the only relevant muni pricing services, I would argue that is not good."

Doe said that consolidation of data pricing providers could make some of these issues more challenging, and could potentially introduce new concerns, including possible antitrust issues and the lack of diversity in a long-standing multifaceted, multi-vendor industry.

"It starts to shake the landscape" of the municipal market, especially at a time of heightened regulation and surveillance, Doe noted.

"You've had a quiet period where data was status quo, and everything went along and innovators brought technology into the market," Doe said. "Now with this tech giant being very aggressive, with lots of money and lots of success and customers on the buy side, it gives them a leg up over something like Market Axess," Doe explained.

The potential for ICE to lead the data pricing industry comes at a time when market participants are "struggling" to maintain liquidity and exchanges are trying to make it easier to comply with increased regulation, he said.

Doe said ICE's leadership is entirely different than various other institutions, like Bloomberg or TMC Bonds, and Market Axess, contributing to market advancements like creating electronic platforms or tweaking technological improvements.

"Now you have ICE coming in buying the two largest data information providers that own buy side customers and influence every evaluation that goes on every investors' statement - individuals and institutions - and they would own that," Doe explained. "That's incredibly powerful."

Among other questions is whether the current evaluation models, such as the Barclays indices, for example, are calculated, he said.

"You have a legacy of triple-A bond insurance to solidify the basis for the triple-A benchmark," Doe said. "But, you bring somebody in who's in control of the evaluation process do they dictate how things are looked at, and can they provide regulators with a better context instead of several vendors?"

"The municipal market does everything off of the high-grade curve, so are those days numbered?" Doe continued. "Will models change and the behavior of the market change?"

On the other hand, Doe said the arrival of ICE into the municipal data pricing industry could open new avenues to the future.

"They tend to go into different markets that were behind in technology and have been able to transform a market place," Doe said of ICE. The move could be a real positive for the market - one that "brings it into the 21st century," he hinted.

Still, Doe said there are wrinkles to be ironed out before the market adapts to a new way of operating with respect to data pricing and evaluations.

"Large sums of money coming into a market place is disruptive, for sure, but hopefully to the positive," Doe said.

"Other institutions have done positive things for the market place and anything that ICE would do, hopefully, the market adapts and the industry only gets better with technology coming into the world of disclosure."

At a time when the municipal market is heading toward increased transparency, the concept of data pricing consolidation hurts rather than helps the industry, and further limits the already error-prone process, according to John Mousseau, managing director at Cumberland Advisors.

"I think we need more pricing services, not less," he said.

"No pricing service is totally correct. Most miss the market when it is in transition to either a higher coupon standard or a lower one, and they misprice it most on premium bonds," Mousseau explained.

Limiting the number of pricing services to a monopoly doesn't add value for clients, and makes comparisons virtually impossible, he noted. "With more than one service at least you can see some degree of difference. How would one compare just a one-source price?"

Ron Valinoti, president at Triangle Park Capital Markets Data who has worked for both IDC and S&P, said the potential disappearance of one of the two major pricing services could have wide-ranging implications for the muni market.

"The other firms are newer, especially to the municipal business," said Valinoti, whose own firm is aggregating data based on observable market data. "Without one of these two familiar services, the market's concern is you have to go out and employ one of these other services. And that's a lot of work."

But beyond the impact for mutual fund portfolio managers, Valinoti said, the data provided by the big pricing services is so pervasive throughout the muni business that it has secondary market effects too. Traders often have to check a screen carrying that data before they can execute a trade, Valinoti said, because the estimated price can sometimes diverge significantly from the actual price someone is willing to pay for a bond at that time. The data provided by the services also makes up a part of the compliance systems broker-dealers use to determine a fair price for a bond in the case of securities that haven't traded recently.

"It's pretty far-reaching," he said.

Valinoti said that all the pricing services try to do "a credible job" of reaching their conclusions, and it is ultimately incumbent on firms who rely on them to do their due diligence in making decisions about how and if they will restructure their policies and procedures to match the new landscape. Many mutual fund companies are currently required by their policies to use two of these services, said Valinoti, though a "bigger, better mousetrap" emerging from the purchase could actually improve price discovery in the muni market, he said.

"If the justice department thinks it's a good idea to allow these dominant firms to merge because the benefit on other side of the fence, like a more efficient marketplace or a new municipal exchange, or more access to market information, then that would be very interesting news to our marketplace," said Strom. "But it doesn't deal with keeping the vendors honest in terms of the future prices they will charge if they dominate a sector of a marketplace."

Strom said that it's safe to say that the regulators from the SEC to FINRA to the MSRB think the muni retail market is pretty inefficient, and that it is dominated by mom and pop investors that need more protection as the end user of bonds through direct purchase, or via money managers and mutual funds.

"As a marketplace, and with our regulators, we will have to find a balance between these forces," said Strom.

The Department of Justice declined to comment on whether it is investigating the acquisitions. It is common for the DOJ to not comment on ongoing investigations.

ICE also declined to comment, as a spokeswoman for the company said that the proposed acquisition of the Standard & Poor's Securities Evaluations business has not yet closed.

Strom said that he isn't sure if ICE creating a muni exchange or other products is a good thing or not, but that he believes it might not work out well for retail investors in terms of cost.

"If the new monopoly or oligopoly in town doesn't have some controls, or regulatory input, in terms of what they charge for their services, just like regulators want more controls on our side of the industry. I would think this topic would need to be dealt with somehow," said Strom.

Strom said that when it is all said and done, the landscape will certainly look different than it does today.

"Small dealers that have dominated the local muni business for 100 years, with its millions of CUSIPs that don't trade every day, will have to adapt," he said. "The big question is whether, in a new world order, where technology and access to information and data rule the day on one side, can that be balanced against monopoly or oligopoly behavior by vendors with pricing, on the other side of the fence?"

"Time will tell whether these dealers in this industry can survive the way we know them today," Strom said.

The Bond Buyer

By Aaron Weitzman and Christine Albano and Kyle Glazier

May 2, 2016

[As Puerto Rico's Storm Grows, Muni Market Is Smooth Sailing.](#)

You'd never know from looking at the \$3.7 trillion municipal market that the largest restructuring in its history is unfolding in Puerto Rico.

Individuals last week poured more money into tax-exempt mutual funds than at any other time this year, just days ahead of the commonwealth's well-anticipated default on \$422 million of Government Development Bank debt. Munis have gained every month this year, only the second time that's happened since 1999. And on the U.S. mainland, prospects are brightening: S&P Global Ratings has upgraded more localities than it has lowered for 13 straight quarters, the longest streak since 2001. Just nine issuers have defaulted in 2016 apart from Puerto Rico, compared with 24 at this time last year.

Much like how Puerto Rico is an island territory off the coast of the U.S., the trends show that investors are treating the commonwealth's debt crisis as separate from the broader municipal market. Monday's default, its largest yet, was a long-time coming: Puerto Rico lost its investment grades over two years ago, and 10 months ago Governor Alejandro Garcia Padilla declared its debt too crippling to pay.

"It was telegraphed," John Miller, who oversees \$110 billion of munis as co-head of fixed income at Nuveen Asset Management, said in an interview on Bloomberg Radio with Tom Keene and Michael McKee. "It's a continuation of an ongoing reality that they don't have the revenues to meet all their budgetary expenses and pay debt service at the same time."

Puerto Rico wasn't the only borrower on the precipice of a historic default. Atlantic City, the

distressed New Jersey gambling hub, made \$1.8 million in interest payments due May 1, after saying it might not. It avoided the first default for a municipality in the Garden State since the Great Depression.

The clearest sign that the market is shrugging off Puerto Rico and Atlantic City is the money pouring into tax-exempt bond funds.

Individuals have added assets to muni funds for 30 straight weeks dating back to October, the longest stretch since March 2010, Lipper US Fund Flows data show. The \$1.2 billion inflow in the week through April 27 was the largest of 2016, and came after Moody's Investors Service warned that a Puerto Rico default was inevitable.

"They are unique," Peter Hayes, the head of municipals for BlackRock Inc., the world's largest money manager, said in a Bloomberg Television interview. "It's been coming for the last few years. Investors were either comfortable or not."

"The market is pretty big. It's \$3.7 trillion. It's different than other fixed-income asset classes. They don't all have problems."

Part of the reason investors have been so willing to buy munis is because the bonds have gained every month this year, S&P Dow Jones Indices data show. It's just the second time that's happened in the past 18 years.

Also padding returns: improving credit quality for states and cities across the country. S&P said in February that it upgraded nearly twice as many issuers as it downgraded in the fourth quarter of 2015. The 13th-straight quarters of elevating more municipalities than it lowered is the longest streak since 2001.

Fitch Ratings said last week that the trend continued: It upgraded 29 issuers and lowered 19 in the first quarter. Positive outlooks are the highest since at least 2001, when Fitch began tracking that, while negative outlooks are the lowest since the third quarter of 2008.

Defaults, aside from Puerto Rico, are also slowing among municipal borrowers. Just nine issuers missed payments for the first time in the first four months of the year, compared with 24 at this time a year ago and 15 in 2014, according to data from Municipal Market Analytics.

Bloomberg Business

by Brian Chappatta

May 2, 2016 — 7:42 AM PDT Updated on May 2, 2016 — 8:22 AM PDT

[American Smoking on the Rise Ignites Tobacco Bonds.](#)

Municipal tobacco bonds have returned 17.4 percent over the past year, more than triple the gain of the broad tax-exempt market, S&P Dow Jones Indices data show. The securities have surged because the cigarette shipments backing them as part of a 1998 settlement agreement increased last year by 1.9 percent, the most ever, according to data from the National Association of Attorneys General. The rally in tobacco bonds, which are mostly speculative grade, is a stark contrast to the other large high-yield segment of the municipal market: Puerto Rico debt is down 4.7 percent in the

last 12 months.

Bloomberg Business

by Brian Chappatta

May 3, 2016 — 7:35 AM PDT

Morgan Stanley Cut From NYC's Senior Muni Bond Underwriters.

New York City cut Morgan Stanley from the ranks of its senior general obligation and Transitional Finance Authority bond underwriters, while elevating Samuel A. Ramirez & Co. and Royal Bank of Canada.

New York, one of the largest issuers of municipal bonds in the \$3.7 trillion market, plans to issue about \$14 billion of general-obligation bonds and \$15.2 billion of Transitional Finance Authority debt in the next four fiscal years, according to the city's financial plan.

The Transitional Finance Authority was created in 1997 to circumvent limits on New York City general-obligation bond sales. State law doesn't allow it to file for bankruptcy and they are backed by the city's income tax, and if needed, its sales tax.

Morgan Stanley's demotion comes five months after the eliminated about 25 percent of its fixed-income staff. The investment bank is included as a senior co-manager for the city's GO and TFA debt.

Mark Lake, a spokesman for Morgan Stanley, declined comment. Carol Kostik, deputy comptroller for public finance, wasn't immediately available for comment, a spokesman said. New York City Mayor Bill de Blasio's office didn't immediately respond to a request for comment.

"Ramirez is thrilled to be added to the GO and TFA syndicate," said Ramirez president and chief executive officer Samuel A. Ramirez. "We are honored to serve the City and we look forward to continuing our work with them for many years."

"We are delighted to be selected. We appreciate the confidence shown in our firm by the City of New York," said John Puig, Managing Director and Co-Head of the New York Municipal Finance Group for RBC.

In addition to Samuel A. Ramirez and RBC, the city's senior GO and TFA bond managers include Bank of America Merrill Lynch, Siebert Brandford Shank & Co., Goldman Sachs Group Inc. Jefferies Group LLC, Wells Fargo Corp., Citigroup Inc., JPMorgan Chase & Co. and Loop Capital Markets LLC.

Cities and states typically pick new underwriting groups every few years to spur competition and respond to staff changes at investment banks. The underwriting group, or syndicate, announced by New York Thursday replaces one set up in December 2012.

Bloomberg Business

by Martin Z Braun

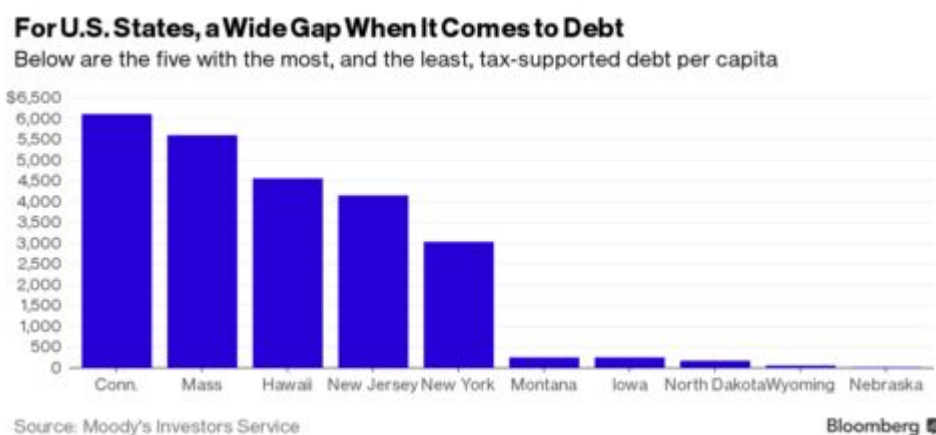
U.S. States Stay in Austerity Age as Debt Barely Budges in 2015.

The debt of U.S. states last year remained below its all-time high from 2013, showing officials were hesitant to borrow even with interest rates near record lows and the recession six years in the past.

States' net tax-supported debt edged up 0.6 percent in 2015 to \$512.5 billion, according to a Moody's Investors Service report released Friday. In 2014, the figure fell for the first time in almost three decades, from the record high of \$516 billion.

After contending with a long recovery from the recession, states and cities have used the \$3.7 trillion municipal-bond market in recent years largely for refinancing instead of running up new debt for public works. There hasn't been a more attractive time in decades for lawmakers to issue long-term bonds: the yield on a Bond Buyer index of 20-year municipal general-obligation bonds fell in February to the lowest since 1965.

"The recent slowdown in debt levels highlights states' reluctance to take on new debt despite continued annual increases in tax revenue," analysts for Moody's wrote in the report. "Several factors will likely suppress growth in state debt burdens in the next year, including the recent decline in commodity markets along with longer term trends of continued uncertainty over federal fiscal policy and healthcare funding."



Connecticut retained its spot at the top of Moody's debt medians, with \$6,155 of net tax-supported debt per resident. That's up from \$5,491 in last year's report.

Massachusetts, Hawaii, New Jersey and New York round out the top five, like the year before, each with more than \$3,000 per person. Nebraska, Wyoming, North Dakota, Iowa and Montana have the smallest burdens, at less than \$250 per resident.

Kansas's debt load in 2015 jumped about 40 percent, the most of any U.S. state, after it issued \$1 billion of pension bonds. South Dakota's grew 20 percent.

Puerto Rico, the U.S. territory on the brink of the municipal market's largest-ever restructuring, wasn't included in the report due to lack of available data. It had \$15,637 of tax-supported debt per person in Moody's prior report.

by Brian Chappatta

May 5, 2016 — 9:01 PM PDT

[A Top Muni Fund's Secret: Buy Tobacco, Stay Clear of Puerto Rico.](#)

One of the best-performing U.S. municipal-bond funds rose to the top with debt backed by a once bankrupt county and cigarette-company payouts at risk as Americans kick the habit. Another driver: It largely steered clear of Puerto Rico.

Money managers Jeffrey Burger and Daniel Barton pushed the Dreyfus High Yield Municipal Bond Fund to a return of 4.5 percent this year, more than any other open-end muni fund that's available to American individual investors, according to data compiled by Bloomberg. The fund, with about \$160 million in assets, has gained 8.6 percent over the past year, besting 93 percent of its peers.

The fund has benefited from gains in the riskiest corners of the \$3.7 trillion municipal market as investors look for bigger returns while yields hold near a half-century low. With money flowing in and debt sales slowing, some of the lower-rated securities have rallied, including those repaid with money states receive from the 1998 legal settlement with tobacco companies.

"A lot of people have been trying to get very few deals," said Barton, who is based in Boston. "The market is likely to continue at a premium, if not get stronger."

The fund's biggest single holding at the end of March was about \$5.8 million worth of New Jersey tobacco bonds due in 2041, with the second \$4.2 million of Ohio's that mature in 2047. Its third largest: a \$3.9 million block of securities sold by Jefferson County, Alabama, in 2013 as it emerged from the bankruptcy. The Dreyfus fund held about \$1 million of debt issued by Puerto Rico, whose growing fiscal crisis led this month to the government's biggest default yet.

The push into tobacco bonds proved prescient. The industry arrested a long-time slump, partly because lower gas prices left consumers with more to spend. Cigarette sales, which determine the size of the legal payments, grew 2 percent last year after declining since 1981, according to a May 2 report by Janney Montgomery Scott LLC. As a result, the securities delivered 17 percent over the past year, more than triple the gain of the broader tax-exempt market, S&P Dow Jones Indices data show.

"Tobacco bonds have taken off thanks to an increase in smoking spurred by lower energy prices," said Burger, who co-manages the fund from Boston at Standish Mellon Asset Management Co.

The Dreyfus fund's investments are scattered over nearly 100 individual securities, which buffers it against risk. The managers declined to comment on specific holdings.

"Diversification is important in the high-yield sector, just as it is in any other kind of investing," said Barton.

The fund's portfolio also included Chicago's wastewater system bonds, private prisons and charter schools in Arizona, and capital appreciation bonds — which delay payments until they mature — that financed California schools and a retirement center.

One criteria the managers weigh heavily: How easy it will be to sell a bond if they want to change course. Recently, the strong demand for high-yield debt — and the diminished pace of new borrowing — has made the market more liquid, they said.

Returns are also being buttressed by the improving finances of state and local governments, which stands in contrast to the high-profile collapse of Puerto Rico. The Caribbean island's long-building strains haven't affected the broader market because investors recognize that its problems are unique.

"You didn't see the contagion in this market that you may have seen in others," said Burger. "Most municipal credit is improving, and we look for bonds that have better credit characteristics."

Bloomberg Business

by Darrell Preston

May 5, 2016 — 2:00 AM PDT Updated on May 5, 2016 — 6:27 AM PDT

[The 'Citigation' Phenomenon: Municipalities Teaming up With Plaintiffs' Firms to File Suits.](#)

The 20-attorney legal department in Providence, R.I., mostly defends the city against lawsuits. But since 2011, it has partnered with outside law firms to file more than two dozen lawsuits alleging a variety of securities and antitrust violations. The outside law firms have funded the litigation in return for a share—a third—of any monetary award.

As we report in today's Wall Street Journal, Providence is one of many municipalities trying its hand at affirmative litigation, amid a slow economic recovery and uneven regulatory enforcement at the state and federal level.

Lawrence Rosenthal, a law professor at Chapman University in California who worked in Chicago's law department, said political and practical considerations figure into decisions by governments to partner with outside law firms.

"It requires no investment of taxpayers funds. All the money is fronted by the plaintiffs firms," he said. "Many smaller municipalities lack in-house expertise as well as in-house resources, so they really have very little choice but to use outside counsel."

Still, municipalities may pay a price.

"You necessarily turn over control, and the litigation can then turn into a pursuit of the private investor's goals at the expense of public policy objectives," Mr. Rosenthal said.

Such partnerships trace to the tobacco litigation in the 1990s, when states paired with trial lawyers to sue cigarette makers. The latest wave of cases builds on a decade-old trend of municipalities and municipal pension funds taking companies and banks to court, plaintiffs' lawyers said.

Municipalities have moved beyond such securities litigation in recent years, filing lawsuits alleging among other things that defendants sold them products at unfair prices, damaged the environment and infrastructure, illegally marketed painkillers and discriminated against minority residents.

Providence adopted its current litigation strategy in 2011.

We report,

Jeff Padwa, Providence's city attorney from 2011 to 2014, said he devised an affirmative-litigation strategy over dinner with then Mayor-elect Angel Taveras days before Mr. Taveras's 2011 swearing-in. At the time, the city's unemployment rate was 11% and its tax base was shrinking.

Mr. Padwa said he modeled the legal department after the Connecticut attorney general's office in the 1990s under Richard Blumenthal, who positioned the state as one of the leaders in the tobacco litigation and joined other states in a suit against Microsoft over alleged antitrust violations.

"Just a few years ago, many municipalities considered class actions with trepidation and maybe even skepticism," said Paul Geller, a founding partner of Robbins Geller Rudman & Dowd LLP, one of the country's largest plaintiffs' firms that specializes in securities litigation.

Mr. Geller said new requests by municipalities for class-action lawyers now surface weekly.

THE WALL STREET JOURNAL

By JOE PALAZZOLO

May 3, 2016 10:05 am ET

[Op-Ed: Universities Should Consider P3s to Meet Infrastructure Needs.](#)

More colleges and universities should consider joining the slowly growing number of institutions that are using public-private partnerships to address infrastructure and other capital needs, argues the head of one nonprofit organization.

Many of these institutions no longer can rely on existing debt capacity, budget surpluses and reserves to maintain and expand their assets. As a result, they should look into allowing outside players to build and maintain some of their infrastructure to save money, free up funds for other priorities and improve their ability to pursue their academic mission, contends Brian Mitchell, director of the [Edvance Foundation](#) in an [April 25 op-ed](#) in the Huffington Post.

For example, colleges that use private financing and expertise to develop on-campus housing can improve students' quality of life, increase enrollment and graduation rates while freeing up money to maintain and add assets, he points out.

Student housing is not the only type of P3s schools are pursuing; others include [Ohio State University's energy P3](#) and the [University of Utah's installation of solar panels](#). Ohio State's project also includes an academic component. Bidders were asked to include in their proposals descriptions of educational opportunities they might offer, such as research projects and collaborative projects with faculty, scholarships, student internships and co-branded energy marketing opportunities.

Mitchell also sees value in P3s that are designed to serve, not only those who study or work on campus, but the surrounding community as well.

“In today’s environment, American higher education — whether public or private — is beginning to use private investment to meet strategic needs that link real estate, student services, academic programs, facilities expansion and town/gown relations together in new and innovative ways,” he explains.

New Jersey City University, for example, has moved beyond student housing P3s and is using [commercial development on school-owned property](#) as an engine for local business and residential growth. Miami Dade College is developing a [P3](#) that combines a multi-dimensional cultural arts center with private residential units, restaurants and retail space. Meanwhile, Boston Mayor Marty Walsh has asked area colleges and universities to build on-campus housing to make more off-campus housing available to local residents, Mitchell points out.

Tapping private financing for student housing and other non-academic projects can free up money for a school to spend on its educational mission, he adds, noting Northeastern University’s plans to use a [P3 to build and manage student dorms](#), which will allow it to fund a new \$225 million science and engineering building.

“There is a growing understanding that the old college business models are insufficient to meet the rigors and demands of newer strategic thinking. The tired, archaic principles that govern the cultural inertia that inhibited private investment are breaking down — especially among the more nimble institutions, those willing to experiment from a position of strength and those that have no choice,” Mitchell writes.

April 28, 2016

[Orrick: Sales Tax Revenue Bonds Provide Critically Needed Transportation Funding Source.](#)

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by Jenna Magan | Devin Brennan

04-26-2016

[Pension Envy: Lessons From Well-Managed Plans.](#)

Bad press has blurred the fact that not all public pension plans are underfunded and overly generous.

Public pension plans have gotten a lot of bad PR in recent years. And while some of that bad press is certainly warranted, it’s wrong to assume they’re all a failure. In fact, there are many plans across

the country that are humming along fine.

Case in point: Missouri's Local Government Employees Retirement System, or LAGERS. Last year, a reporter for the Springfield News-Leader wanted to know why the city's pension plan was just 80 percent funded — far below the fund's aggregate 94 percent funding level. LAGERS has the ability to compel payments from cities, so the reporter, Amos Bridges, wondered if the fund was letting Springfield off the hook.

As it turned out, LAGERS wasn't. The current funding level only reflected active employees; It was closer to 90 percent when incorporating retirees. Additionally, LAGERS had Springfield on a payment plan to get back to a fully funded status.

"Defeated in my search for a scandal, I had to admit: These LAGERS people seem to know what they're doing," Bridges [wrote](#).

But the News-Leader's complimentary column is more the exception than the rule. Rarely is news ink ever used on a foiled search for a scandal. So what's driving the generally negative coverage? Pension envy.

At a time when few Americans have any substantial retirement savings, public pensions are one of the only vehicles left that offer workers real retirement security. What's more, the ones that make headlines seem overly generous to taxpayers working in the private sector. Financial advisors recommend a retirement income somewhere around 70 percent of a retiree's salary, and the average American has far less than that saved.

In 2014, a [study](#) by the conservative American Enterprise Institute found that full-career state workers in five states — California, New Mexico, Oregon, Texas and West Virginia — earned more in retirement income than in their final salary.

But it's unfair to label all pension plans as overly generous taxpayer burdens. In the above five states and others, lawmakers enhanced benefits — often without paying for them — when times were good. The added-on benefits pushed liabilities higher and unfunded liabilities grew faster. Sometimes, governments skipped out on making their full pension payment, which added to the pressure. Then, the losses during the Great Recession only made matters worse. That's simply not the case in many other states.

Employees, though, shouldn't be relying alone on their public pension plans, according to LAGERS Executive Secretary Keith Hughes. One's retirement plan should also include personal savings and social security benefits where available.

"We don't believe the pension's purpose is to create wealth for the member and their family forever and ever," said Hughes. "We believe it is to provide [security] for them for their lifetime. If members want [a plan] to provide wealth, there's probably another vehicle to do that."

Part of the reason LAGERS and other similar plans are able to make their annual payments is because their benefits are modest and held in check. Replacement salary for these plans are typically between 30 and 50 percent of the employee's annual salary. Often, there are checks and balances when it comes to adding benefits. LAGERS, for example, requires a cost study before a contributing government is allowed to enhance its benefits. And no government is allowed to increase benefits without paying for them.

So why don't more places operate like these plans?

Speaking for the municipal plans, Hughes does admit that managing more than 1,000 plans — with their own menu of benefits — for about 700 governments is a lot of actuarial work.

Furthermore, not every place is capable of enforcing a payment mandate like LAGERS and other well-run plans. Those plans can intercept tax money collected by the state that's due to the municipality if that government is delinquent on its pension bill. In addition to LAGERS, Illinois' municipal fund and Idaho's public employees fund mandate payment by state statute. Texas has the pension payment mandate in its constitution.

In the end, the pension envy resulting from some of the bad PR could present a unique opportunity for a larger discussion.

"I think one of the challenges is that a lot of Americans right now have nothing," says Bailey Childers, head of the National Public Pension Coalition. "I think the question is, how do we take some of the benefits of professionally managed pensions and take that to private sector?"

GOVERNING.COM

BY LIZ FARMER | APRIL 28, 2016

[When Debt Meets Public Approval: Municipal Bond Elections in San Antonio, Texas.](#)

Institute of Municipal Finance & Governance Presentation.

Jacqueline Peterson
IMFG Blanche and Sandy Van Ginkel Graduate Fellow, 2015-16
PhD Candidate, Political Science
University of Toronto

[Read the Presentation.](#)

[U.S. Supreme Court Invalidates Maryland Power Generation Incentive Program On Preemption Grounds.](#)

On April 19, 2016, the U.S. Supreme Court decided *Hughes v. Talen Energy Marketing, LLC*. In its opinion, authored by Justice Ginsburg, the Court rejected the attempt by the State of Maryland to incentivize the construction of new power plants through the use of a contract for differences. A contract for differences would guarantee the price paid to a developer for capacity in the PJM capacity market. The Court found that such action by a state is preempted by the Federal Power Act (FPA) and implied preemption. Duane Morris previously referenced the pendency of this case in the February 19, 2016, Alert, ["What Does U.S. Supreme Court Decision Upholding FERC's Authority Over Demand Response Mean for the Future of FERC's Jurisdiction?"](#)

In so ruling, the Court further supported FERC's authority to regulate competitive wholesale markets for electricity, including the interstate wholesale rate FERC requires. The effect of a contract for differences is to set a different capacity price for power from the plant than paid by

other participants in FERC's capacity auction. Although Maryland's intent was to encourage construction of new in-state generation, the Court found that Maryland's program, by adjusting the interstate wholesale rate for power sold by a plant holding a contract for differences but selling into the FERC auction, contravenes FPA's division of authority between federal and state regulators.

The Court left open whether there may be other means available to the states to encourage the construction of generation in transmission constrained areas. The Court limited its holding to Maryland's program because that program disregarded FERC's required wholesale rate. The Court specifically stated that its opinion does not rule on the permissibility of other measures that a state might employ to encourage the development of generation, such as tax incentives, land grants, direct subsidies, construction of state-owned generation or re-regulation of the energy sector. It remains to be seen how incentives can be crafted by states so that they do not impermissibly affect wholesale market prices.

Article by Phyllis J. Kessler

Last Updated: April 26 2016

Duane Morris LLP

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[S&P's Public Finance Podcast \(Higher Education Trends and the Rating Actions on Catholic Health Initiatives and Atlantic City Municipal Utilities Authority\)](#)

In this week's Extra Credit, Analytical Manager Jessica Matsumori discusses the trends shaping the higher education sector, Director Scott Garrigan explains what's behind the multiple notch downgrade on Atlantic City Municipal Utilities, and Senior Director Kevin Holloran reviews our recent downgrade on Catholic Health Initiatives.

[Listen to Audio](#)

Apr. 25, 2016

[After Bankruptcies, Murky Future for California POBs.](#)

LOS ANGELES — The future of pension obligation bonds remains cloudy in California in the wake of the haircuts imposed on their holders in the San Bernardino and Stockton bankruptcies.

Municipal bond industry professionals interviewed for this article disagreed about the future viability of POBs in California.

Tom Schuette, partner and co-head of portfolio management for Gurtin Fixed Income, said the firm holds some of the taxable securities for its investors.

"As with all securities, we are highly selective and look to the overall credit quality of the obligor," Schuette said.

"We believe the bankruptcies are a reminder to avoid distressed obligors, which Stockton and San Bernardino were, not a cautionary tale to avoid entire security classes," Schuette said. "We would anticipate that while obligors may have to pay up slightly to issue POBs in the future given the losses felt by San Bernardino bondholders, we still would expect high quality obligors to be able to find a receptive market."

Schuette says the prices in California pension obligation bonds have not changed in the last month, and that POBs from high-quality California obligors are generally trading slightly off of their GO debt, but not by significant levels, he said.

California taxable pension obligation bonds were pricing in the 3.09% to 4.6% range for 10 years and in the 4.84% to 5.57% range for 30 years on Tuesday, according to Markit.

Marilyn Cohen of Envision Capital Management said she never thought POBs were a good idea – even before the bankruptcies.

"I have been railing against how pension obligation bonds should not be in anyone's portfolio for a long time," she said.

She thinks the tough treatment of POBs in the two California bankruptcies will give future investors — and issuers — pause.

"As the stresses continue in pension liability, investors will demand more and more yield, so that it will be untenable for issuers to sell POBs," Cohen said.

She said she won't put her money or her clients' money in POBs because the rate of return does not match the risk.

In the San Bernardino Chapter 9, the settlement deal with pension obligation bondholders and insurers calls for the city to give them what it describes as a 40% recovery over the long term.

It's significantly more than the 1% the city first proposed, but continues a trend of bonds faring worse than pensions in Chapter 9 cases, as in Vallejo, Calif., Detroit and Stockton.

John Knox, a partner with Orrick, Herrington & Sutcliffe, said investors should not have been surprised that the pension obligation bonds were impaired, because they are an unsecured credit – and that is how unsecured credits are treated in bankruptcy.

"Clearly, the Stockton case and San Bernardino have both shown — which is not a surprise to me or other bond lawyers — that pension obligation bonds are an unsecured promise to pay by the municipality," Knox said.

POBs are a promise by the municipality to pay, just like borrowed money on a consumer line of credit, Knox said.

"I think folks thought there was more there, they might have thought there was some additional level of security," Knox said. "If you are dealing with an unsecured obligation and there is a secured obligation, the secured obligation is more likely to be paid."

He added he doesn't think the decisions in the bankruptcies have changed the rules.

"If you have an unsecured obligation and the debtor goes into bankruptcy, that is likely to be impaired," Knox said.

Though the California cases don't change the rules of the road, Knox does think they will change investor perception of pension obligation bonds.

"I have always scratched my head when rating agencies rated POBs higher than lease obligations, but I'm not a rating agency," he said.

While the asset backing a lease obligation could be damaged or destroyed, the bonds do have that asset backing the bonds, which provides some level of security, he said.

But for whatever reason, before Stockton, the rating agencies tended to rate POBs a notch higher than lease obligations, he said.

"As far as I know, nothing represents a change in structure for pension obligation bonds, or represents anything people should be surprised about in how they were treated in bankruptcy," he said, "because any unsecured obligation is at higher risk than a lease obligation."

Knox thinks the structure of future California POB issues could evolve into lease-backed financings.

"I am not surprised when any investor is upset about being impaired in bankruptcy," he said. "Before Vallejo, Jefferson County, Stockton and Detroit there was a feeling that munis would never go bankrupt - and you did not have to think about it too much. Now that a few have - and it is a small number compared to the universe of issuers - I think people are waking up and saying: 'If this does happen, what do we have?' In the case of a pension bond, it's an unsecured obligation."

In San Bernardino, the European bank that held the POBs raised the argument, rejected by the court, that if the city keeps paying pensions it should continue to pay the pension bonds, Knox said.

"I have heard that argument before, it holds no water," Knox said. "The fact that they settled for the amount they did belies the fact that creditors didn't believe it either. In one case, they didn't even raise it. In San Bernardino, they raised it but lost."

Investors should have been drawing distinctions between general obligation bonds, pension obligation bonds and lease revenue debt, Knox said.

"Muni bonds aren't monolithic," he said. "There are scores of different kinds of muni bonds. They have different credit scores and different payment sources. I don't see that that is different from 10 years ago. Now that a few have gotten into trouble, people realize they were not paying enough attention to the distinctions."

According to Robert Christmas, a Nixon Peabody partner, the issue always boils down to one question: What is the nature of the security?

"Pension obligation bonds are one of the elephants in the room for municipal finance and they are going to have to be dealt with," Christmas said. "And maybe issuing bonds to deal with pension liability is not the way to go."

Pensions are clearly a huge issue in municipal finance in terms of the solvency of the issuers, he said.

"The focus to me is not the subject of the issuance, but what is the statutory framework in that state

for bondholders,” he said. “We have clear statutory liens or narrow issuance for revenue bonds, which are protected under the bankruptcy code.”

What Stockton and Detroit pointed out is that while investors might think they have a lien, they may not because the statute isn’t clean, Christmas said. That is what led to haircuts for bondholders in the Detroit workout.

“I haven’t worked on a POB deal, but it strikes me that they are from another era where there were ever higher pension costs and no one thought the market would tank on that,” Christmas said.

What investors need to contemplate is whether POBs are helping to smooth out the operations of a municipality or are a Band-Aid hiding a larger issue, he said.

“As we saw in Stockton and San Bernardino, a lot of issuers don’t have the appetite to litigate over claims priority with state agencies (like the California Public Employees’ Retirement System), to whom they owe money,” he said. “And agencies might have statutory frameworks involving the cities owing pension funds money.”

Cities must also weigh their ability to market bonds in the future if they give bondholders too steep of a haircut, whether on pension obligation bonds or other bond categories.

“We know in Chapter 9 everyone is going to take a haircut,” Christmas said. “If you cut the hair too short, you aren’t back in the market. It could be years (before a city is able to market bonds again).”

Orange County, bankrupt in 1994, was able to sell bonds not too long afterward, as part of California’s strong coastal economy with strong property values and affluent taxpayers, Christmas said.

Investors take that into account, he said.

The Inland Empire’s San Bernardino and the Central Valley’s Stockton, with high crime rates and less affluent populations and tax bases, don’t have the same economic strengths going for them.

The Bond Buyer

By Keeley Webster

April 28, 2016

[Financial Experts and Social Service Providers Challenge State, Municipal, and Chicago Public Schools Payments to Wall Street Banks.](#)

Chicago, IL -(ENEWSPE)-April 27, 2016. On Wednesday, a set of financial experts and social service providers gave testimony before the Illinois House Revenue and Finance Committee detailing how Wall Street banks have soaked all levels of government in Illinois for hundreds of millions of dollars through interest rate swaps and other complex financial deals.

“In essence the banks lured the state of Illinois into a suckers bet – heads I win, tails you lose,” stated Saqib Bhatti, Director of the ReFund America Project. “During the budget stalemate this year, while the Governor has refused to fund critical services, the state has nevertheless paid more than

\$92 million in fees to banks. \$68 million of this money was for toxic swaps—the same toxic swaps that have drained more than a billion dollars out of the Chicago and CPS’s budgets.”

The panel of experts included: Saqib Bhatti, ReFund America, Greg Will, SEIU HCII, Jonathan Jackson, Business Professor at Chicago State University; Brad Miller, Former US Congressman; and Tom Sgouros, Senior Policy Advisor, Rhode Island General Treasurer.

The expert panel questioned the ability of local and state governments to win bets against savvy Wall Street bankers.

“The parties to an interest rate swap are each taking different sides of a bet. One party is betting that interest rates will rise, while the other is betting they will fall. Pricing risk is a tricky business. People write doctoral dissertations about it, and win Nobel prizes in Economics for figuring out the essential problems involved,” explained Sgouros.

“There are many other specific risks that the banks knew well and even the most sophisticated public issuers did not. The failure to disclose those risks seems very much like a realtor not telling a homebuyer that the basement floods,” added Miller.

In addition to the interest rate swaps the panel of experts pointed out the numerous add on fees that have continued to be paid during the budget impasse despite the lack of a budgetary authorization. “The state has paid banks and other finance industry companies for a litany of fees and charges: letters of credit, other credit enhancements, remarketing fees, trustee fees, ratings agency fees, fees to counsel, underwriter fees, fees associated with cash management functions – the list goes on,” explained Greg Will, Research Director for SEIU HCII.

Experts made clear that the state paying these fees without a budget was likely illegal, “What’s truly scandalous is that the Governor’s office is actually breaking the law to pay the banks. The state has paid more than \$10.5 million in bank fees that have no budget authorization. These are illegal payments,” said Saqib Bhatti.

Prioritizing payments to Wall Street banks over human service providers is having a devastating impact on the social service infrastructure in Illinois. Inspiration Corporation, an agency that provides job training and employment placement, supportive housing, meals, and other services to Chicago’s homeless and low-income residents has had to lay off staff and reduce services as a result of late payments from the state.

Evan Cauble-Johnson, Chief Development Officer at Inspiration Corporation explained during the hearing, “Study after study has shown that the cost of providing supportive housing to the homeless is a fraction of the cost of relying on emergency services like policing, emergency medical care, or incarceration. If we do not preserve supportive housing for our most vulnerable neighbors now, if we choose to direct the money that we have towards interest payments on risky loans instead of on vital services to our most vulnerable neighbors and fellow citizens, not only do we fail the people that need our support the most, we fail ourselves. We will pay for this choice down the road. There is no avoiding it.”

[Municipal Bonds For The Rest Of Us: A Startup Seeks To Democratize Public Finance.](#)

In 2012, entrepreneur Jase Wilson and bond broker Patrick Hosty came up with a novel way to open

up public finance to small investors: create an online marketplace allowing regular folks to invest smaller-than-usual amounts of money in municipal bonds backing specific civic projects of interest.

"If people had more ways to invest in these bonds they would," says Rodrigo Davies, chief product officer of [Neighborly](#), the company Wilson and Hosty founded. "It just hasn't been on their radar."

But it was a tall order, requiring tackling a complex financing system with a fairly new technology. So Wilson and Hosty decided to get their feet wet by first launching a crowdfunding platform for financing community projects, like parks and bicycle lanes. In its first two years, the Kansas City, Mo.-based startup raised about \$3 million for over 60 projects. Wilson had started a company by the name of Luminopolis to build open-source software systems for cities, so he already had experience with tech entrepreneurship.

By 2014, they figured they were ready for prime-time—their well-planned pivot into the municipal bond market. When they were accepted into 500 Startups, the San Francisco accelerator, they moved their headquarters to the Bay Area. (Hosty stayed in Kansas City). Not long after, the company raised \$5.5 million in a seed round from Formation 8, Sound Ventures, which is actor Ashton Kutcher's VC firm, and others.

The basic concept is to offer a platform through which unaccredited investors can buy portions of a municipal bond. Many moons ago, bonds were clear-cut instruments tied to defined projects, like building the Golden Gate bridge. (A framed 1930's bond certificate from the Golden Gate Bridge and Highway District adorns a wall in Neighborly's office and an appropriately breath-taking picture of the bridge is the first image that greets visitors to the company's web site). Over time, they've become more complex and confusing, as multiple projects have been combined into one bond. These days, much of the \$3.8 billion municipal bond market—that figure is from the company—is held by wealthy individuals who want the tax break.

With Neighborly, investors answer a few questions online about their areas of interest, like education or the environment, and then the platform matches them with appropriate choices. The company will sell the financial instruments through its own registered broker-dealer.

Still in beta, the platform is now open to anyone who works in public finance, from underwriters to public agencies, that can sign up and start using the data on the site. It also includes a variety of tools providing such features as an easy way to do issuance comparisons. Next step is to allow individual investors to participate and to make investments well below the usual minimum level of \$5,000. In a recent survey by Neighborly, a majority of respondents said they'd like to invest about \$1,000.

Individuals also will be able to do research on investments, drilling down so they can see everything from the population living in a project's area to disclosures. For now, the focus is on school districts in California—the sector surveys revealed to be the most popular—but the plan is to expand to other sectors eventually.

Davies predicts the platform could boost civic engagement and citizen involvement in local communities. He also acknowledges that the company has a long way to go. "Our investors realize this is a 200-year-old market and there's a lot of work to do," he says. "But it's also a big opportunity."

FORBES

by Anne Field

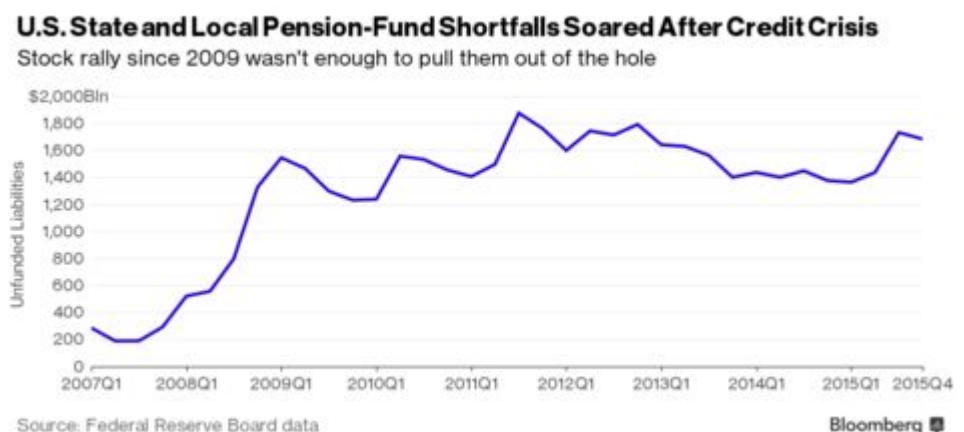
U.S. Pensions Solve New Debt Equation. Answers Vary by Billions.

When Kentucky Governor Matt Bevin proposed his budget in January, he told lawmakers the teacher retirement system had \$13.9 billion less than needed to cover promised pension benefits. The state's audited financial statements earlier estimated the shortfall was about 55 percent larger, at \$21.6 billion.

The discrepancy for the pension that serves 122,000 current and former school workers didn't result from a secret investment windfall that slashed its debt. It's because of a gulf that's emerged between official figures that are disclosed to municipal-bond investors — and those states and cities can rely upon when deciding how much they need to pay into their retirement funds.

New accounting rules that took full hold last year prevent governments from counting on investment returns after they're broke, a technique that masked the scale of the debts they face as workers retire. But outside of their certified books, they're free to sideline it.

"There is great confusion about the numbers and what they mean," said Robert North Jr., former chief actuary for New York City's pension funds. "Whatever numbers are used are dependent on how they are created, what they represent and their purpose."



The strains of America's public pension funds have taken on renewed importance since the credit crisis, which saddled them with investment losses from which they haven't fully recovered. By the end of 2015, state and local government retirement systems had \$1.7 trillion less than they will eventually need, up from a \$293 billion shortfall eight years earlier, according to Federal Reserve Board figures.

Because governments typically count on investment returns of more than 7 percent a year, when they fall short of that they need to pump additional money into the funds to catch up. Such financial pressure led Moody's Investors Service to cut Chicago's bond rating to junk last year and threatens to exaggerate the fiscal crisis in Puerto Rico. It can also pose risks to municipal-debt investors if a government goes broke: In the major bankruptcies that followed the recession, bondholders bore deeper losses than retirees.

When Governments Go Bankrupt, Bondholders Bear the Cost

Pensions checks, a retiree lifeline, take priority when cash runs out



The changes from the Governmental Accounting Standards Board were aimed at addressing concerns that states and cities were using investment-earnings forecasts to minimize the size of their unfunded debt to retirees.

As a result, when putting a current value on pension obligations due far in the future, they now have to use less aggressive assumptions for the years after they run out of cash. That increases the stated liability.

The standards, which aren't required by federal regulations, don't mandate how governments calculate their annual payments into the funds, said Keith Brainard, who tracks pensions for the National Association of State Retirement Administrators.

"Systems are generating two numbers for two different purposes," said Brainard. "One for accounting and one for funding."

The difference can be significant. When New Jersey sold bonds earlier this year, it put both in the official documents that were provided to investors. Under the old accounting standard, it's unfunded liability was \$43.8 billion. Under the revised one, \$78.8 billion.

With the new rules, the funding level of the Kentucky Teachers' Retirement System is 45.6 percent, meaning it has 45.6 cents for every dollar it owes, according to the annual financial report released in December.

Governor Bevin used the more well-funded level of 55.3 percent when asking the legislature to determine how much money the state needs to allocate for the pension.

The higher figure is reflection of different assumptions, said Mark Bunning, Kentucky's deputy finance secretary. "The numbers we use can change over time as assumptions about investment returns evolve," he said.

If the funding level is higher, governments don't have to pony up as much, which means they may eventually not have enough to cover what they owe to retirees, said Chris Tobe, a pension consultant who previously served as a trustee of the Kentucky Retirement Systems.

"They have to use GASB when they issue bonds, but when they seek funding from the legislature it's better to go with higher numbers," said Tobe. "The larger numbers make them look better funded

and then they don't have to raise taxes or cut spending on education."

The accounting standards setter anticipated that government officials would take time to get used to the new rules.

"It's something we would expect during this transition period as some take comfort in having the old numbers," said Kip Betz, a spokesman for GASB. "I expect we'll evolve away from that over time."

In the meantime, it's sowing some confusion about the financial health of the retirement plans. "The public would have a better understanding if the two numbers could be reconciled in a way that would make clear what they mean," said David Crane, a lecturer of public policy at Stanford University.

Bloomberg Business

by Darrell Preston and Neil Weinberg

April 27, 2016 — 2:00 AM PDT

[Record Municipal Junk Bond for Hospital Set as Market Draws Cash.](#)

The need to protect against earthquakes is about to jolt the municipal junk-bond market from its slumber.

California's Loma Linda University Medical Center on Wednesday is planning the biggest speculative grade, tax-exempt health-care deal since at least 1990, according to data compiled by Bloomberg. The \$883 million sale will finance an expansion and overhaul to comply with the state's seismic safety requirements, a project that will double the center's debt and triggered a fall from investment grade last year.

The offering will gauge whether investors are growing more willing to buy the riskiest securities as cash floods into municipal-bond funds and yields hold near a five-decade low. It comes after underwriters have struggled since last year to line up buyers for other big speculative-grade sales, delaying issues from a Florida passenger railroad and a Texas methanol plant.

"The market is a little bit yield starved," said Steve Czepiel, a senior portfolio manager in Philadelphia at Delaware Investments who oversees a \$1.15 billion high-yield municipal fund that holds some of the California hospital's securities. "This is a very good time for them to bring this deal to the marketplace."

Investors' increasing allocations to the municipal market have boosted prices this year as the Federal Reserve has held off on raising rates since its initial increase in December. By late last week, investors had added money to state and local debt funds for 29 straight weeks, the longest streak since March 2010, Lipper US Fund Flows data show.

The supply of new securities hasn't kept pace with the influx. This year, about \$121 billion have been sold, down 13 percent from a year earlier, according to data compiled by Bloomberg.

"Cash flows into the market are very strong and there is very little to own," said Blake Anderson, managing director in high-yield securities trading at Mesirow Financial in San Francisco. "It's an

auspicious time for the hospital to issue a substantial amount of debt.”

Loma Linda’s center, located about 60 miles (96 kilometers) east of Los Angeles, will use the proceeds to cover the bulk of its \$1 billion project, which will add 983,000 square feet of hospital space and bring the complex into compliance with seismic safety rules that take effect in January 2020. Its facilities lie near two major earthquake faults.

Credit-rating companies downgraded Loma Linda last year because of the debt issue. This month, Standard & Poor’s cut its grade again, dropping it one step to BB, the second level into junk, saying the medical center has little financial room to maneuver if the project encounters delays. Fitch Ratings has a stable outlook on its BB+ grade, the first step into junk.

Susan Onuma, a spokeswoman for the hospital group, declined to comment.

The yields on some Loma Linda bonds have risen relative to benchmark securities ahead of the offering. A bond due December 2044 traded Monday at an average yield of 4.19 percent, or 2.7 percentage points over top-rated debt, data compiled by Bloomberg show. That gap is up from about 2 percentage points in December 2014, when they were first issued.

The new securities will only be sold to qualified institutional buyers, such as mutual-fund managers, instead of individual investors, because of the “material degree of risk,” according to offering documents.

“In buying this type of bond, you have to be comfortable with the long-term outlook of the credit,” said Dan Solender, head of municipals at Lord Abbett & Co. in Jersey City, New Jersey. He manages \$18 billion of municipals, including those issued by Loma Linda.

Bloomberg Business

by Romy Varghese

April 26, 2016 — 2:00 AM PDT Updated on April 26, 2016 — 6:00 AM PDT

Where Did the Government Jobs Go?

On a muggy afternoon in April, Angelina Iles, 65, folded herself into my passenger seat and took me on a tour of her beloved Pineville, La., a sleepy town smack in the middle of the low, wet state. We drove past spaced-out, low-slung houses and boarded-up businesses — shuttered restaurants, a decrepit gas station — as Iles, an African-American retired lunchroom worker and community activist, guided me toward the muddy banks of the Red River. Near there stands the locked-up Art Deco shell of the Huey P. Long hospital, which once served the poorest of the poor in Rapides Parish — and employed more than 300 workers.

When employers leave towns like Pineville, they often do it with a deaf ear to the pleading of state and local governments. But in the case of Huey P. Long, the employer was the government itself. Its demise began, arguably, in 2008, when Bobby Jindal was swept into the Louisiana governor’s mansion on a small-government-and-ethics platform, promising to modernize the state and unleash the power of American private industry along the Gulf Coast. At the time, Louisiana was flush with federal funds for Hurricane Katrina reconstruction and running a budget surplus. Jindal and the State Legislature slashed income taxes and started privatizing and cutting. This was a source of

great pride for Jindal. During his failed bid for the presidency last year, he boasted that bureaucrats are now an endangered species in Louisiana. "I've laid off more of them than Trump has fired people," he said, "and I've cut my state's budget by more than he's worth."

He laid off more than just bureaucrats. Jindal cut appropriations for higher education, shifting the cost burden onto students themselves. (State spending per student was down more than 40 percent between 2008 and 2014; just one state, Arizona, cut more.) And he shuttered or privatized nine charity hospitals that served the state's uninsured and indigent. They were outdated and costly, Jindal argued, and private management would improve access, care and the bottom line. Huey P. Long was one of those hospitals.

Iles, along with dozens of other workers and activists, helped organize a protest against the cuts, she told me. They held a vigil on the hospital's front lawn. Iles even helped produce an anti-Jindal documentary called "Bad Medicine" that was broadcast on local television. But it was all for naught. "The good governor did not want to listen to us," Iles said, checking her constantly buzzing phone in the car. The hospital closed its doors in 2014, and its patients were redirected to other local medical centers and clinics. All of the hospital's workers lost their jobs.

Driving around Pineville, Iles and I dropped in on a friend of hers from church, Theresa Jardoyn, 68, who worked in the hospital for 41 years, most recently as an EKG supervisor. Out of work, she spends most of her days at home, taking care of her family. Earlier, Iles had introduced me to another friend, Linette Richard, whose story was similar. She had been working as an ultrasound technician when the hospital closed. She lost much of what she had been expecting for her retirement, because she had not been there long enough. "Nobody's jumping to hire a 58-year-old, especially in my field," Richard said. "You can get a low-paying job, like McDonald's or Burger King. But higher up? We don't have positions available. That's the way it is."

That's the way it is across much of Louisiana. The state has added 80,000 new jobs since the Great Recession officially ended in 2009. But at the same time, jobs have been shrinking at every level of government, with local offices losing 10,600 workers, the state government 31,900 and the federal government 1,600. Louisiana is an exaggerated case, but the pattern persists when you look at the country as a whole. Since the recession hit, private employers have added five million jobs and the government has lost 323,000. The country has recovered from the recession. But public employment has not.

The public sector has long been home to the sorts of jobs that lift people into the middle class and keep them there. These are jobs that have predictable hours, stable pay and protection from arbitrary layoffs, particularly for those without college or graduate degrees. They're also more likely to be unionized; less than 7 percent of private-sector workers are represented by a union, while more than a third of those in the public sector are. In other words, they look like the blue-collar jobs our middle class was built on during the postwar years.

The public sector's slow decimation is one of the unheralded reasons that the middle class has shrunk as the ranks of the poor and the rich have swollen in the post-recession years. This is certainly true in Louisiana, where five of the 10 biggest employers are public institutions, or health centers that in no small part rely on public funds. In Rapides Parish, which includes Pineville, the biggest employer is the school district.

Across the country, when public-sector workers lose their jobs, the burden disproportionately falls on black workers, and particularly women — people like Theresa Jardoyn and Linette Richard.

"We felt middle class," Richard told me. "Now we feel kind of lower."

In the middle of the last century, a series of legal and legislative decisions — fueled by and fueling the civil rights movement — increased the number of black workers in government employment. F.D.R. ended official discrimination in the federal government and in companies engaged in the war effort; Truman desegregated the armed forces; Kennedy established the Committee on Equal Employment Opportunity; and Johnson signed an executive order banning discrimination by federal contractors. As a result, black workers gained more than a quarter of new federal jobs created between 1961 and 1965. And the share of government jobs held by women climbed 70 percent between 1964 and 1974, and nearly another 30 percent by the early 1980s.

Through the middle of the century, the wage gap between white and black workers narrowed as social forces and political pressure compelled private businesses to open up better jobs to black workers. “Public-sector work has been a backbone of the black middle class for many reasons,” says Mary Pattillo, a sociologist at Northwestern who studies race and class. Affirmative action helped bring marginalized groups into the public work force; there, they benefited from more public scrutiny of employment practices. “The inability to fire people in a willy-nilly fashion has likely protected African-Americans, who are perhaps likely to be fired in a willy-nilly fashion,” she says. As of 2007, black workers were 30 percent more likely than workers of other races to be employed in the public sector.

For any number of reasons, the Great Recession unraveled much of the progress made by the black middle class. Leading up to the mortgage crisis, black families tended to have a higher proportion of their wealth tied up in their homes. And regardless of their income, black families were much more likely to be rejected for conventional mortgages and pushed into high-cost subprime loans. All of this meant that when housing prices turned down, the black-white wealth gap yawned. As of 2013, white households were, on average, 13 times wealthier than black households, the biggest gap since 1989, according to Pew Research Center data.

Declining tax revenue led to tightened state budgets, which led to tens of thousands of layoffs for public-sector employees. And during the recovery, public workers became easy political targets precisely because of their labor protections. Collective-bargaining rights, pension funds and mandatory raises look like unnecessary drains on state coffers to a work force increasingly unfamiliar with such benefits. And when the layoffs came, black Americans experienced a disproportionate share of the ill effects. A graduate student of sociology at the University of Washington, Jennifer Laird, wrote a widely cited dissertation, examining the effects of public-sector layoffs on different races. She found that the government-worker unemployment rate climbed more for black men than for white men — and much more for black women than for white women, with the gap between the two groups soaring from less than a percentage point in 2008 to 5.5 percentage points in 2011. “It may be that black workers are more likely to be laid off when the layoffs are triggered by a sudden and significant reduction in funding,” she wrote. “When the number of layoff decisions increases, managers have more opportunities to discriminate.” Worse, once unemployed, black women were “the least likely to find private-sector employment and the most likely to make a full exit from the labor force.” As a result of all these economic punishments, a recession that set America back half a decade may have set black families back a whole generation, if not longer.

And because the public sector provides so many essential services, cuts to it have a cascading effect. Hospitals close, and people have to drive farther away for medical care. Teachers’ aides lose their positions, and local kids no longer have the same degree of special-education attention. Angelina Iles, the retiree I met in Pineville, cited the loss of dental, mental-health and emergency medical services as being a particularly profound problem for her community.

Other states and towns are electing to have smaller public work forces. Wisconsin, for instance, has thinned its ranks of government workers by some 5,000 since its Republican governor, Scott Walker,

led a push to abrogate public workers' organizing rights — a political choice with profound economic and racial ramifications. "They try to say that collective bargaining is a drain on the economy, when it provides the ability and opportunity for folks to have a seat at the table," Lee Saunders, the president of the American Federation of State, County and Municipal Employees, told me. And the economic evidence does show that a higher concentration of unionized workers increases intergenerational mobility and raises wages for all workers, public and private.

With time, government jobs should come back; that pathway to the middle class should grow again. "Government jobs are always slower to come back after a recession," says Roderick Harrison, a former Howard University demographer. It takes time for private businesses to rehire workers. It takes time for tax revenue to rise to a level at which cities and states feel comfortable adding public workers back onto their payrolls. "That means that the portion of the black middle class that was dependent on government jobs — police, schools, emergency workers and so on — is going to take longer to recoup and regain whatever positions they had," he says.

For Pineville, that recovery might come too late for many of its workers, especially those who were looking toward retirement. Because Linette Richard can't find suitable work, she and her husband get by on what he makes as a car salesman. She has given up trying to find work again around Pineville. So has Theresa Jardoine, who has resigned herself to a tougher retirement than she thought she would enjoy.

"All of a sudden, there's nothing," she said, sitting in an easy chair in her living room, just blocks from Huey P. Long, playing with her granddaughter's hair. "You can't enjoy retirement in this situation."

"You didn't even get a pocket watch, did you?" Iles asked.

"No," Jardoine said, with a resigned laugh. "Just aches and pains."

THE NEW YORK TIMES

By ANNIE LOWREY

APRIL 27, 2016

[Fitch Launches Analytical Sensitivity Tool for State & Local Governments V2.0](#)

Fitch Ratings-New York-18 April 2016: Fitch Ratings has launched its '[Fitch Analytical Sensitivity Tool – States & Locals \(FAST\) V2.0](#)', in conjunction with the publication of Fitch's updated U.S. Tax-Supported rating criteria. Fitch has also published a special report describing FAST's functionality and theoretical basis.

As an integral part of the updated criteria, FAST is not a forecasting tool but instead generates a revenue scenario specific to each issuer. The scenario is based on a common GDP stress, providing insight into revenue trends through the cycle.

FAST is a highly interactive tool that allows users to:

- Select from the more than 700 individual state, town, county and school district issuers embedded in FAST;

- Enter hypothetical issuer/revenue series;
- Form issuer peer groups based on region and demographics;
- Examine annual and period historical revenue performance for individual issuers and sectors tabularly and graphically;
- Gauge future revenue performance/volatility over the cycle given a user-specified macro scenario;
- Graphically view the impact of the generated revenue stress on three years of issuer finances through dedicated state and local scenario analysis tabs.

FAST is a large spreadsheet-based tool that may work better with newer versions of Excel. Users must ensure that macros have been enabled in order to utilize the complete functionality of the tool and are advised that Excel should be closed before opening the file. Access to the tool and all criteria-related documents is available at www.fitchratings.com on a complementary basis for three months. Registration is required.

Fitch Updates U.S. Tax-Supported Rating Criteria.

Fitch Ratings-New York-18 April 2016: Today Fitch Ratings has published its updated U.S. Tax-Supported rating criteria report. Rating changes as a result of the criteria implementation are expected to be minimal.

Notable aspects of the new criteria include:

- Published assessments of four key rating factors will drive rating outcomes in the context of the economic base: revenue framework, expenditure framework, long-term liability burden and operating performance.
- Most Fitch-rated state and local government tax-supported issuers will have Issuer Default Ratings, which are equivalent to unlimited tax general obligation ratings.
- Scenario analysis will provide a framework for consistently communicating Fitch's forward-looking view regarding the issuer-specific impact of a cyclical downturn on revenues and the options available to address the resulting budget gap. This approach conveys a range where a rating would likely remain stable or for potential rating changes.
- This through-the-cycle analysis incorporates the Fitch Analytical Sensitivity Tool - States & Locals (FAST). FAST generates a revenue scenario based on a common GDP stress, grounded in historical data for each issuer. FAST provides insight into an issuer's revenue trends through the cycle and allows for peer analysis. FAST is not a forecasting tool.

In addition to the updated criteria report, Fitch has released three related reports, all of which are available at www.fitchratings.com or by clicking the links below. [One report summarizes industry feedback](#) received during the comment period for the criteria exposure draft, which commenced on Sept. 10, 2015, and Fitch's response to that feedback.

The second report is a [user guide](#) that describes how Fitch will administer the criteria. This guide is in response to requests by market participants during the exposure draft period.

Finally, Fitch has released a report describing FAST, in addition to the tool itself. (For more information see 'Fitch Launches Analytical Sensitivity Tool - State & Local Govt's V2.0' at www.fitchratings.com.)

Access to the tool and all criteria-related documents is available through the website on a complimentary basis for three months. Registration is required.

Fitch will host a conference call to discuss the final criteria on Thurs., April 21 at 2:00 EST. To receive dial-in details for the call, please register here: <http://dpreregister.com/10084380>.

The updated '[U.S. Tax-Supported Rating Criteria](#)' published today replaces the following criteria reports:

- 'Tax-Supported Rating Criteria' (August 2012)
- 'U.S. State Government Tax-Supported Rating Criteria' (August 2012)
- 'U.S. Local Government Tax-Supported Rating Criteria' (August 2012)
- 'Rating Guidelines for State Credit Enhancement Programs' (April 2013)
- 'Rating Guidelines for Moral Obligations' (April 2013)

Department of Labor's "Novel" Reading of the Davis-Bacon Act Fails Again.

On April 5, 2016, the U.S. Court of Appeals for the District of Columbia held that the Davis-Bacon Act and its higher wage requirements do not apply to the development of the CityCenterDC project in Washington, D.C. Assuming there are no further appeals, the Court's decision brings to an end an eight-year battle by the Mid-Atlantic Regional Council of Carpenters and U.S. Department of Labor (DOL) to broaden the reach of the Davis-Bacon Act. The Court's decision left open questions that impact how private-public partnerships are structured to take advantage of the Government's vast property holdings and need for development and infrastructure upgrades.

Davis-Bacon Act. The 1931 Davis-Bacon Act ("DBA") was originally intended to prevent non local contractors from moving into an area and winning federal construction contracts by using cheaper itinerant labor. The DBA, as amended, requires that each contract over \$2,000 to which the United States or the District of Columbia is a party for the construction, alteration, and/or repair of public buildings or public works shall contain a clause setting forth the minimum wages to be paid to various classes of laborers and mechanics employed under the contract. These minimum wages are to be no less than the locally prevailing wages and fringe benefits paid on similar projects. In addition, Congress has added prevailing wage provisions to approximately 60 statutes that assist construction projects through grants, loans, loan guarantees and insurance. These "related Acts" involve construction in such areas as transportation, housing, air and water pollution reduction, and health. This application of prevailing wages to so many statutes and construction projects makes the CityCenterDC case very important as prevailing wages have historically made construction projects more costly. In the case of CityCenterDC, estimates are that the project would have cost approximately \$20 million more were the DBA to have applied.

CityCenterDC. CityCenterDC is a mixed-use development that includes 325,000 square feet of retail space (including luxury stores such as Gucci, Hermès, Dior, and Louis Vuitton), 520,000 square feet of office space, approximately 450 apartments, 216 condominiums, and a luxury hotel. The District of Columbia (the City) owns the land on which CityCenterDC sits, and leased it to a private developer on a series of 99-year ground leases. The developers and the City also entered into development agreements that required the developers, not the City, to contract with general contractors to develop the property at the developers' cost.

The Decision. The Court was unwilling to broaden application of the DBA to cover projects that had

never previously been subject to the DBA, that is, projects that are privately funded, privately owned, and privately operated. In coming to its decision, the Court strictly interpreted the language of the DBA in holding that CityCenterDC was not subject to the DBA because the City was not a party to the actual construction contract, and the project is not a public work. The Court noted that for a project to be considered a public work, either or both of the following must apply: (i) public funding for the construction, or (ii) government ownership or operation of the completed facility. In the case of CityCenterDC, neither applied. In one of the most quoted portions of the Court's opinion, the Court stated that it was "unwilling to green-light such a massive, atextual, and ahistorical expansion of the Davis-Bacon Act. The concept of a public work may well be elastic. But it cannot reasonably be stretched to cover a Louis Vuitton. CityCenterDC is not a public work."

Unanswered Questions and Practice Tips

In a pair of very important footnotes, the Court expressly left open two very important questions, with others being implied.

(1) Footnotes 2 and 5 - Does a project have to meet both elements of the public work test, or just one?

TIP - While the Court's discussion of this point suggests that there could be an argument in favor of both elements having to be met, plan for the worst (that only one element must be met). Avoid project structures that involve the City (i) paying rent for the property or providing funding for the construction, or (ii) providing more than standard zoning oversight, or controlling or operating the project post-completion.

(2) Footnote 4 - What about situations where the project is structured with an intermediary so that the Government is not in a direct contract with the general contractor?

TIP - Make sure there is a legitimate business purpose for the deal structure. Ensure files are sufficiently documented to mitigate against allegations that the structure is a sham arrangement to avoid application of the DBA to the project.

(3) At what point are zoning oversight, as well as tax and other development incentives, deemed Government funding of the project and/or control of the project?

TIP - Avoid management control of the project by the Government. Try to structure tax incentives so they are tied to the developer and not the project itself.

The Court's decision should come as a welcome relief to a large number of contractors that have their eye on the trillions of dollars of infrastructure projects, but fear that the application of the DBA to those projects will drive up costs, making some projects not worth pursuing.

Those interested in reading the opinion can do so [here](#).

Last Updated: April 19 2016

Article by Susan Borschel

Morrison & Foerster LLP

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

Authorizing Pay for Success Projects: A Legislative Review and Model Pay for Success Legislation.

Pay for Success (“PFS”) is a model for deploying government resources that drives funding toward social programs that prove effective at providing results to people with the most need. Under a PFS model, government agrees to pay for a service contingent on the program having measurable impact. If there is no impact, government does not pay. Impact funders and philanthropists provide the funds to pay for program delivery while impact is being evaluated and bear the risk that there will not be any proven impact. PFS initiatives have garnered substantial media attention, with the focus primarily on the innovation, the intervention and parties themselves.

Despite the rapidly growing interest in Pay for Success contracting in the United States, little attention has been given to the enabling environment, including regulatory policy. The regulatory situation, principally state and local legislation, is an essential yet overlooked component of these interventions. Given the direct impact, predominance and progress of state- and local-level PFS legislation, this paper¹ focuses on state and local legislative initiatives, analyzing the choices legislative bodies should consider when drafting and revising PFS legislation. We analyze history, enactment, and primary features across jurisdictions. We then offer legal and policy recommendations for lawmakers considering future PFS legislation, based on the following key questions:

- Should legislation be PFS-specific or should the State rely on general contracting authority?
- Should legislation be focused on a specific transaction or rather serve as a general grant of authority?
- Should the PFS contract result in a general obligation of the State?
- Should a sinking fund be included?
- Should legislation require cost savings within a particular timeframe or focus instead on resource allocation?
- Should legislation require outcome based payments or provide greater flexibility?
- Should an evaluation be required?

II. Pay for Success Overview

PFS is taking off nationally. As of February 2016, eleven PFS projects have launched in nine jurisdictions across the U.S., beginning with New York City’s Recidivism Reduction Initiative in 2012.² PFS projects exist in Democratic and Republican-leaning jurisdictions, encompassing diverse issue areas, such as recidivism, early childhood education, and chronic homelessness. As of February 2016, we estimate that there are in excess of 20 in development across the U.S.³ The Sorenson Impact Center, a Division of David Eccles School of Business, University of Utah, estimates that 39 states have project feasibility studies, many of which may lead to newly-launched projects in the near future.⁴

To continue reading this article, please [click here](#).

Footnotes

1. Perry Teicher (JD/MBA) is the Impact Finance Fellow at Orrick, Herrington & Sutcliffe LLP, a

leading global law firm; John Grossman (JD/MBA) is the CoPresident and General Counsel and Marcia Chong is a Senior Analyst at Third Sector Capital Partners, Inc., a non-profit that advises governments and others on the creation of Pay for Success projects. As a Summer Associate at Third Sector Capital Partners, Inc., Michael Yakima assisted in putting together this paper.

2. Press Release, N.Y.C. Office of the Mayor, Mayor Bloomberg, Deputy Mayor Gibbs and Corrections Commissioner Schiri Announce Nation's First Social Impact Bond Program, available at <http://tinyurl.com/j8aj4yo>.

3. See e.g., Third Sector Capital Partners, <http://www.thirdsectorcap.org/projects/>; Sorenson Impact Center, <http://www.policyinnovationlab.org/pay-for-success/>.

4. Sorenson, <http://www.policyinnovationlab.org/pay-for-success/>.

Last Updated: April 18 2016

Article by Perry Teicher, John Grossman and Marcia Chong

Orrick

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Moody's U.S. State and Local Government Credit Conditions Outlook: Smoother Sailing--Maybe--After a Turbulent Start.

The turbulence that defined equity markets in early 2016 has subsided somewhat and various indicators suggest that the U.S. economy should continue to expand at a moderate pace throughout the year. In fact, Standard & Poor's Ratings Services' economic outlook as of April looks remarkably similar to its January forecast despite the intervening volatility. Due to slower first quarter growth than we had anticipated, we have lowered our forecast of real GDP growth in 2016 to 2.3% from the 2.7% we projected at the outset of the year. The revised growth rate does not correspond with a higher risk of recession, however. The forecast estimates a relatively low—15% to 20%—likelihood of recession this year.

For state and local governments, the forecast anticipates a broadly stable economic backdrop, albeit one that lacks the underlying vitality we would typically expect to see at this stage of the business cycle. We expect trends in consumer spending and a housing market that continues to gather momentum to be among the key supports for U.S. economic growth through 2016 and into 2017. We project housing starts to continue marching upward, reaching 1.2 million in 2016 and 1.4 million in 2017. Real consumer spending should continue to increase, but at 2.8% in 2016 and 2.6% in 2017, the pace of growth would be slightly slower than the 3.1% growth rate in 2015. This anticipated levelling-off in consumer spending is consistent with the now five-month low in consumer sentiment and what we observe in state tax revenue forecasts. Almost across the board, states are forecasting slower, though still positive, rates of personal income and retail sales tax revenue growth.

Overview

- Revised forecast anticipates slower economic growth in 2016.
- Risk of recession remains relatively low—15% to 20%.

- Slower economic growth aligns with state revenue forecasts, which have also been dialed back.
- Key economic supports are consumer spending and momentum in the housing market.
- Regional forecasts anticipate that states in the Mountain, South Atlantic, and Pacific regions are leading the way.

[Continue reading.](#)

19-Apr-2016

S&P's Public Finance Podcast (State Housing Finance Agencies and California's State Teacher Retirement System)

In this week's Extra Credit, Senior Director Mikiyon Alexander discusses our new article on rated state financing agencies and Senior Director Gabe Petek examines some of the recent pension reforms to the California State Teacher Retirement System, or CalSTRS, and the potential impact on the state's credit quality.

[Listen to the podcast.](#)

Apr. 18, 2016

Rising Rate Fears Live On as Pimco, Vanguard Pass Over 4% Munis.

For municipal-bond buyers, sometimes it's not all about yields.

In California's \$3 billion general-obligation debt sale last month, it offered two bonds with identical 20-year maturities. One segment yielded 3.24 percent; the other, 2.89 percent. Why the discrepancy? The higher-yielding bonds pay annual interest of 4 percent, a full percentage point less, making them a risky bet that interest rates won't rise significantly over the next decade, according to money managers at AllianceBernstein Holding LP, Pacific Investment Management Co. and Vanguard Group Inc.

Yield-starved investors have few other alternatives as tax-exempt interest rates remain near generational lows, which has left the smaller-coupon securities selling at a comparative discount amid speculation that borrowing costs have nowhere to go but up. Extending maturities isn't alluring: the difference between 2- and 30-year tax-exempt debt is the lowest since 2008. Nor is taking on more risk: the extra yield received from BBB instead of AAA rated debt is near the smallest in at least three years.

"In the bond fund space, as a way to pick up additional yield, there's been a larger appetite for going down to 4 percent coupons," said Chris Alwine, head of municipals in Malvern, Pennsylvania, at Vanguard, which holds \$157 billion of the securities. "That strategy will do OK as long as rates remain range-bound, but we're going to be very selective."

The divergent yields on bonds with identical maturities stems in part from quirks in the \$3.7 trillion municipal market, where most securities give the issuer the option to call them back before they're due, usually after 10 years, in case they can be refinanced at a lower cost. In the corporate market,

by contrast, the debt is more likely to remain outstanding until maturity.

States and cities have almost always exercised that buyback option because interest rates have been largely on the decline since the 1980s. In 20 of the past 30 years, yields on long-dated general-obligation bonds ended lower than where they started, according to a Bond Buyer index.

If they went up significantly, which would cause prices to fall, some securities — particularly those with lower coupons — probably wouldn't be called, leaving investors forced to sell at a loss or hold them until maturity.

"The question is do you pick up enough yield to compensate for that extension risk?" said Guy Davidson, who oversees \$33 billion as director of municipal fixed-income in New York at AllianceBernstein. He said in many cases, the answer is no. "You should pick up yield to go down in coupon, because obviously if yields rose, it has a better chance of extending to its maturity."

The California deal offered an additional 0.35 percentage point on debt due in 2036 with a 4 percent coupon rather than 5 percent. The Los Angeles Unified School District last month issued two sets of 2040 bonds with those interest rates at the same spread. So did Massachusetts, on general obligations maturing in 2041.

'Price Cliff'

For David Hammer, co-head of municipals at Pimco, that difference isn't enough. That's because of another market quirk, known as the de minimis rule, that limits the tax break for owners of state and local debt.

When they buy tax-exempt bonds at a deep discount to 100 cents on the dollar, or par, any price gains are subject to the income-tax, not the lower capital-gains levy that usually applies. Coupon payments remain tax free.

That price discount, which Pimco estimates to be 97.5 cents for a 10-year bond issued at par, is called the de minimis threshold. Crossing it creates a "price cliff," according to the firm, because the bond will keep dropping until the yield rises enough to offset the additional taxes.

If interest rates jump, causing the value of outstanding securities to fall, those with the lowest coupons would be the first to breach the de minimis limit.

In Connecticut's bond sale last month, for example, 4 percent debt due in 2034 priced at 105 cents, compared with 115.8 cents for 5 percent bonds. At those prices, it takes a smaller increase in interest rates to invoke the de minimis rule on the 4 percent bonds and raises the odds that investors will be holding the debt past its call date.

Even with a patient Federal Reserve — which has held off since it's initial increase in December — that's not a risk Hammer said he's willing to take.

"Lower coupons in this grab for yield have become overvalued," said Hammer, who oversees \$45 billion of municipals in New York at Pimco. "Even in an environment where rates are lower for longer, if you're not being compensated for that additional duration risk, it's not a trade that I think will work out very well over time."

Bloomberg Business

by Brian Chappatta

Moody's: Enhanced Pension Disclosures Under GASB 68 Improve Credit Analysis but Leave Underlying Credit Risks Unchanged.

New York, April 18, 2016 — The added disclosure of pension liability exposure for US states and local governments under Governmental Accounting Standards Board (GASB) Statement 68 enables improved credit analysis of the relative strength or weakness of government contributions, according to Moody's Investors Service in a new report. GASB 68 allows Moody's to establish a new "tread water" indicator, which measures the minimum annual contribution required from a government to prevent its net pension liability (NPL) from growing under reported assumptions.

The report, "FAQ: Improved GASB Pension Disclosure Does Not Eliminate Need for Adjustments," addresses frequently asked questions about the new standards, which do not alter credit risk stemming from unfunded pension liabilities.

"Underlying credit risk from pensions remains, as does our need for balance sheet adjustments to reported data," says Thomas Aaron, a Vice President at Moody's. "Our analytical approach to pensions will only be affected minimally."

Moody's considers pensions as debt-like balance sheet obligations that are unaffected by the new reporting rules, which increasingly separate financial reporting on pension exposure from the funding of government pension obligations. For example, the reporting of pension obligations on government balance sheets under GASB 68 is no longer related to the record of payments against the Annual Required Contribution (ARC) funding standard.

The FAQ outlines how Moody's "tread water" analysis measures whether government contributions are sufficient to pay down part of reported unfunded pension liabilities, using the required disclosure of "service cost" under GASB 67 and 68. Those governments with contributions above this threshold are stronger from a credit perspective than those below.

"Ratios comparing government contributions to the "tread water" level and "tread water" costs to government revenues shed light on budgetary fixed cost burdens stemming from pensions," Aaron says.

The new GASB standards also provide better information regarding the sensitivity of liabilities to discount rate changes, allocations of cost-sharing plan exposure, and projected asset depletion dates, in some scenarios.

The report is available to Moody's subscribers at

https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1013199.

Fitch: No Defaults Recorded for U.S. Public Finance in 2015.

Fitch Ratings-New York-18 April 2016: The positive rating drift for U.S. public finance that began in 2014 persisted through 2015, according to a new Fitch Ratings report. Downgrades trailed upgrades

by a margin of 0.4 to 1, tightening from 2014's ratio of 0.7 to 1. The overall stability rate improved year over year to 89% from 87% the previous year.

U.S. public finance securities downgraded and upgraded remained low in 2015, with the total declining year over year by a third. The share of ratings affected by downgrades and upgrades was 1.6% and 3.7% in 2015, respectively.

Fitch-rated U.S. public finance security ratings recorded no defaults in 2015.

The report also includes details on Global Infrastructure and Project Finance (GIG) transition and default performance. GIG rating activity was positive with upgrades outpacing downgrades. The 2015 downgrade-to-upgrade ratio was 0.5 to 1.

Fitch recorded four GIG security defaults in 2015. As a result, the Fitch GIG securities annual default rate was 1.07%.

Fitch's new study provides transition and default analysis on the performance of U.S. public finance and GIG in 2015 and over the long term period. The report provides summary statistics on the year's key rating trends.

The full report is titled 'U.S. Public Finance and Global Infrastructure and Project Finance 2015 Transition and Default Study' and is available on Fitch's website.

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[Next Week in Bankruptcy.](#)

The city of San Bernardino, Calif., could get one step closer on Wednesday to getting out of bankruptcy after nearly four years.

Judge Meredith Jury is scheduled to look over a description of the 77-page plan that shows how city leaders will cut the municipality's biggest debts and increase services for its roughly 200,000

residents. The plan, if approved, would be sent to creditors for a vote.

Judge Jury has rejected past proposals, but the latest version includes a key settlement with a European bank that once fought to protect future payments of \$95 million for the bonds it bought. San Bernardino officials said they will make payments that add up to about \$50.7 million over the next 30 years instead.

San Bernardino stopped repaying the bonds once it filed for bankruptcy on Aug. 1, 2012, projecting it would run out of money in less than two months. The city that sits about 60 miles east of Los Angeles has suffered from double-digit unemployment and lower tax revenue from fallen property values.

The deal means that San Bernardino's bondholders will be paid a much higher percentage than other creditors, including general unsecured debtholders who are owed roughly \$200 million and would be paid only 1% of that amount. That group includes businesses that provided city services, plus more than 100 individuals and families who have filed in excessive-force lawsuits for injuries and deaths allegedly caused by San Bernardino police officers and employees.

San Bernardino officials, however, defended the low repayment rate in documents filed in U.S. Bankruptcy Court in Riverside, Calif., saying that municipal services have been "cut to the bone" in recent years.

"The city needs to dedicate every dollar available to it to rebuild those municipal services," city officials said in court papers.

The plan doesn't call for any immediate tax increases on its residents. City officials cited U.S. Census Bureau data that found 32.4% of residents live below poverty level.

"The city remains the poorest community of its size in California, and it has grown progressively poorer over the past decades," city officials said in court papers.

A Houston bankruptcy judge could enable oil and gas firm Black Elk Energy Offshore Operations LLC to clear a similar hurdle at a court hearing on Friday.

Judge Marvin Isgur is scheduled to look over a bankruptcy-exit plan's summary for the company—one of many energy company stung by fallen oil prices. Since filing for bankruptcy, Black Elk says its operations are limited to four platforms as well as 16 additional platforms that are being decommissioned.

Black Elk is also dealing with criminal charges in connection with a fatal explosion on a welding platform in the Gulf of Mexico. The lawsuits allege Black Elk didn't follow proper safety precautions and rushed the work, resulting in the deaths of three workers, as well as injuries. On March 21, court papers show Black Elk pleaded not guilty to the criminal charges and asked to have the charges dismissed.

Black Elk was pushed into bankruptcy by four of its creditors in August, when they filed an involuntary chapter 7 petition against the company. Regulators soon after said the company had failed to put in place a safety and environmental management system program.

On Monday, a Delaware judge is scheduled to look over the voting results for Nuo Therapeutics' plan to exit bankruptcy behind its flagship drug, a gel used to treat skin ulcers.

Judge Mary Walrath could sign off on the Maryland biomedical company's plan, which includes two

possible scenarios: emerging from bankruptcy if it can raise \$10.5 million in equity capital through a private placement or health-care-focused hedge fund Deerfield Management getting 95% of the reorganized company's common stock.

If Nuo exits bankruptcy under the first scenario, Deerfield—which has been lending money to the company throughout its chapter 11 case—will receive preferred shares valued at \$29.3 million. Existing shares will be canceled under both scenarios.

Nuo Therapeutics traced the company's financial troubles to the government's reimbursement rate of \$435 per treatment for Aurix, a "hematogel" that uses a patient's own platelets and plasma as a catalyst for healing. The hospital reimbursement rate for Aurix, by contrast, has been boosted to more than \$1,400 per treatment, according to documents filed in U.S. Bankruptcy Court in Wilmington, Del.

Company officials have called Aurix the only therapy of its kind cleared by the Food and Drug Administration for use for the treatment of a variety of ulcers and wounds.

THE WALL STREET JOURNAL

By KATY STECH

Apr 22, 2016 12:59 pm ET

-Patrick Fitzgerald and Lillian Rizzo contributed to this article.

Write to Katy Stech at katy.stech@wsj.com. Follow her on Twitter at @KatyStech

Municipal Bond Defaults Shake Up a Once-Sedate Market.

Municipal bond issuers have been in the news in recent years for all the wrong reasons, starting with places like Jefferson County, Ala., and Stockton, Calif., defaulting on their municipal bonds. Then Detroit filed for bankruptcy, with \$18 billion in debt on its books.

And there's Puerto Rico, which is struggling to make its bond payments — or decide which of its \$72 billion in municipal bonds to default on.

Still, money has continued to flow into municipal bonds, a market dominated by individual investors. There have been 27 straight weeks of inflows into municipal bond funds, according to Dan Heckman, senior fixed income strategist with U.S. Bank wealth management.

The main reason for municipal bonds' continued strength is that the interest paid on municipal bonds is free of federal and state taxes, which can exceed 50 percent for top earners in states like New York and California. Those savings give the bonds a substantial advantage over Treasury bonds with similar yields and even higher-yielding corporate bonds.

Still, selecting municipal bonds is not as simple as it was before the spate of defaults changed what was generally a stodgy asset class.

"The municipal bond market has transformed from what used to be a rates market like Treasuries to a true credit market like the corporate world," said John Bonnell, a portfolio manager at USAA.

"It used to be a given that if the issuers had the ability to pay their debt, they would," he said. "Now, it's their willingness to pay that's become more of a focus. Some of these issuers end up with budget situations where they have to pick and choose who's going to get paid what."

Before the financial crisis of 2008 and several high-profile defaults, municipal bond investors relied more on the rating of the bonds, something that an issuer could improve by buying insurance on them.

"What mattered was underlying credit quality and the issuer, but it got obscured for a long time by municipal bond insurance," said John Bussel, chief investment officer of Hewins Financial Advisors, which manages \$4 billion for wealthy investors.

"Shakier issuers would buy municipal bond insurance to get them a AAA rating," Mr. Bussel said. "When people were buying muni bonds from a broker, he would say they're AAA insured."

When the crisis came, the solvency of municipal bond insurers was tested, since they had also branched out into insuring the bonds created out of mortgages. While about 55 percent of municipal bonds had insurance in 2008, that number is around 6 percent today. And the number of insurers has dwindled to three from seven.

Mr. Bonnell at USAA said he would rather have no bond insurance, "because we're doing the work," adding, "I'd prefer the issuers didn't pay for the insurance and I'd have the extra yield."

At the moment, shorter-duration municipal bonds are more in favor than longer-duration bonds, even when they pay a quarter of what the longer ones do, because interest rates are expected to rise and the shorter term all but guarantees investors will be paid back.

"Six months to one-year munis have become a bigger part of the market," said Kimberly Foss, founder of Empyrion Wealth Management. "Today, it's about high-quality municipalities that will be able to pay the duration of the bond and give people the income they need. What's left in their pocket after taxes is the most important thing for them."

With longer-duration municipal bonds, the concern is that an increase in interest rates will erode the value of the investment.

"The biggest risk is with long bonds," said Todd M. Morgan, chairman of Bel Air Investment Advisors, which manages \$3 billion. "Interest rates are unpredictable. They go up 100 basis points," or 1 percentage point, "and you could lose 20 to 30 percent of your investment."

As to determining which municipalities will not be able to make their payments for longer-dated bonds, investors can look to the recent past for a lesson — few of the problems cropped up overnight.

"You may get into fiscal difficulties like a Detroit or a Puerto Rico, but those things had a long tail and were running out," Mr. Heckman of U.S. Bank said. "It shouldn't have come as any surprise that Detroit ran into financial problems."

Mr. Bonnell said that investors also needed to bear in mind political changes in the municipalities themselves.

"When it comes to the willingness to pay part, the officials you bought that bond from might be totally different 10 years from now," he said. "It's hard to predict with a 30-year bond."

He added, "If it looks like things are deteriorating and they're going to have to prioritize, hopefully if you've done your work correctly, you'll be out of it by then."

The long time horizon shows the value of having someone watch the municipalities, which is something that bond managers do but is also a role played by municipal bond insurers for individual investors.

Natalie R. Cohen, the head of municipal research at Wells Fargo, said that even though the remaining insurers are writing policies on a small number of new bonds, they play a role in negotiations for existing issues "with high-powered legal help in distressed situations, such as Detroit, helping to battle for bondholder recoveries."

Bill Fallon, chief executive of National Public Finance Guarantee Corporation, a municipal bond insurer, said his firm was doing just that on general obligation bonds from Detroit. He said the holders of the city's bonds continued to receive interest and principal payments.

While these insurers still have a marketing problem from the financial crisis, Mr. Fallon said that their coverage continued to be needed by smaller municipalities or those that do not regularly sell municipal bonds.

"If a large A-rated municipality is issuing \$300 million, institutional buyers will know the issuer and put the resources toward it," Mr. Fallon said. "Put that against an Iowa school issuance and it's for \$17 million, it's unlikely you'll have a large institutional manager putting the staff behind it."

Brenda Wenning, who manages \$22 million in fixed income for 30 clients, said that if her clients bought municipal bonds with insurance, it was generally for longer-dated bonds and for municipalities where they lacked the time or knowledge to do the analysis.

"Buying insured bonds removes having to understand each bond's creditworthiness and allows the client to sleep at night," she said.

For people buying municipal bonds on the secondary market, the more general risk comes from the lack of transparency on what the dealers paid for a bond and what they are selling it for.

"Most of the transactions in the secondary market are conducted through a broker or a discount broker, and the individual investor doesn't have the horsepower or tools for price discovery," Mr. Heckman said.

The Municipal Securities Rulemaking Board has started a website, called Electronic Municipal Market Access, to help investors track the buy and sell prices on municipal bonds.

But in the end, what matters now is understanding the bond issuers more deeply. "Credit analysis is important," said Mr. Bussel at Hewins Financial Advisors, "and it's hard to do credit analysis on muni bonds."

THE NEW YORK TIMES

By PAUL SULLIVAN

APRIL 22, 2016

Financing Infrastructure: Why Public-Private Partnerships Matter.

After decades of underinvestment, we face an extreme infrastructure deficit in the United States. In order to bring our infrastructure into the 21st century and support a growing economy, we need to invest more in essential projects including highways, water and sewer systems, bridges, airports and more.

The problem we face is not a lack of capital – it is the ability to identify reliable funding sources to support debt service, to support return on capital and to support maintenance costs. In the coming years, there will be an increasing convergence of Public-Private Partnerships (P3) and the municipal bond market to successfully finance big infrastructure projects. A key regulatory issue is the same availability of tax-exempt financing for P3 projects as traditional municipal-bond financed initiatives. Simultaneously, we are exploring how we can make existing investment dollars go further. Innovative approaches like design-build enable us to do just that.

[Watch the video.](#)

SIFMA

By: Michael Decker

April 19, 2016

Puerto Rico Crisis Spreads as Fewer Issuers Can Avoid Junk Fate.

As Puerto Rico's fiscal crisis reaches a tipping point, even some of the island's strongest borrowers with few or no ties to the government are finding themselves struggling to stave off a junk credit rating.

Standard & Poor's lowered almost \$100 million of tax-exempt debt backed by Sistema Universitario Ana G. Mendez, a private non-profit college with multiple Puerto Rico campuses, to BB+ from BBB- last month. The cut, the first in over a decade, puts the bonds below investment grade, a blow to investors including OppenheimerFunds Inc., Massachusetts Financial Services Co. and Capital Group Cos.

Of the \$70 billion in municipal bonds that Puerto Rico and its agencies issued, just \$1.7 billion remains investment grade, data compiled by Bloomberg show. Much of the higher-rated debt is backed by private universities and hospitals with no direct government ties, while the tangled web of commonwealth borrowers is deep in junk status. The Ana G. Mendez downgrade shows that the island's economic stagnation and population loss is reaching corners of the Puerto Rican bond market still owned by investors who have otherwise fled.

"Even though they may be independent from the financial problems of the commonwealth, they're not independent of that economy, and that economy continues to contract," said Guy Davidson, who oversees \$33 billion as director of municipal-fixed income in New York at AllianceBernstein Holding LP, which owns \$3 million of Ana G. Mendez bonds. He wrote in an online posting last month that Puerto Rico debt wasn't yet a good investment.

Remaining Few

The largest portions of investment-grade bonds on the island include tobacco securities from the Children's Trust Fund, housing obligations backed by Fannie Mae and Ginnie Mae and debt from the Hospital Auxilio Mutuo Obligated Group, data compiled by Bloomberg show. Ana G. Mendez, named after the Puerto Rico-born educator, had been the fourth-biggest non-junk borrower before its downgrade.

Universidad Interamericana de Puerto Rico and Universidad Del Sagrado Corazon, rated A- and BBB- by S&P, respectively, have about \$62 million of bonds outstanding, Bloomberg data show. Like Ana G. Mendez, the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority issued the debt. They also have overlapping investors.

The biggest mutual-fund owners of Ana G. Mendez bonds reveal some typical Puerto Rico investors — OppenheimerFunds holds the most, with \$32.6 million — and some unusual ones. Massachusetts Financial has a \$22.7 million stake, second-highest, followed by Capital Group, USAA Investment Management Co., Franklin Resources Inc. and AllianceBernstein, Bloomberg data show.

The university system has three main campuses in Puerto Rico and another that's virtual, plus three centers in Florida, one in Maryland and one in Dallas. Its overall enrollment of about 40,000 in 2015 was flat relative to the prior year and a vast majority of its students were from Puerto Rico, according to S&P.

Building Reserves

"While management projects flat Puerto Rico enrollment in the foreseeable future, we believe enrollment could decline given Puerto Rico's weak economy and prolonged recession," S&P analysts Shivani Singh and Charlene Butterfield wrote in their report downgrading the university.

The system isn't planning any more bond sales or capital projects in the coming years, instead focusing on maintenance and building cash reserves, Alfonso Davila, vice president for financial affairs, said in a telephone interview. Students will receive the same services and education that they've always had, he said.

"The system will never default on its payments," Davila said. "People think Puerto Rico is not in a good condition, but the government is the one having the problems. We in the private sector are doing our best to improve the situation of the Puerto Ricans here and in the states."

Ana G. Mendez bonds maturing in March 2026 traded on April 1 at an average 86 cents on the dollar, to yield about 7 percent, data compiled by Bloomberg show. By comparison, an index of BBB rated revenue bonds due in 10 years yields 2.6 percent. Similar-dated Iowa Fertilizer Co. bonds rated BB- by S&P, used as a barometer for speculative grade munis, yield about 4.24 percent.

"The bonds offer attractive risk-adjusted spreads relative to other non-investment grade options," Geoffrey Schechter, a portfolio manager at Massachusetts Financial, said in an e-mailed statement.

Spokespeople for OppenheimerFunds, Capital Group and USAA declined to comment. Stacey Coleman, a spokeswoman for Franklin, said no one was available to discuss the holdings.

Tainted View

The Ana G. Mendez downgrade preceded a wave of moves by the commonwealth to address its fiscal strains. Governor Alejandro Garcia Padilla on April 6 signed a law that would allow him to halt

payments on a wide swath of Puerto Rico bonds through January 2017. He declared an emergency period for its Government Development Bank on April 9. Two days later the island released a counterproposal to creditors to cut its obligations.

The securities are tainted by the association with Puerto Rico and trade as if they were rated four steps lower, Davidson said. He's not planning to sell his holdings, though he isn't looking to buy, either.

"The school is part of the future economic turnaround for Puerto Rico at some point," Davidson said. "I don't think you'd want to accumulate much until at least you can see a path to a more stable economy. In the next few months, we'll have anything but clarity."

Bloomberg Business

by Brian Chappatta

April 13, 2016 — 2:00 AM PDT Updated on April 13, 2016 — 5:43 AM PDT

[As Puerto Rico Nears Record Default, Insured Investors Rest Easy.](#)

The mutual-fund company with the biggest stake in Puerto Rico bonds that are almost certain to default on July 1 isn't worried.

That's because Wells Capital Management's \$23 million position in the island's general-obligation debt is entirely backed by units of bond insurers Assured Guaranty Ltd. and MBIA Inc., which agreed to pay investors if Puerto Rico doesn't. That guarantee has distanced Wells Capital and other bondholders from a crisis that's been rapidly unfolding over the past nine months and reached a new pitch last week, when Puerto Rico's governor signed a law authorizing him to halt payments on much of its \$70 billion of debt.

"I haven't even really thought about them not making a payment," said Lyle Fitterer, head of tax-exempt debt in Menomonee Falls, Wisconsin, at Wells Capital, which oversees \$39 billion of the securities. "We haven't been involved in any of the negotiations. It's really seamless for us."

As Puerto Rico veers toward a record-setting default, the insurers have created a haven for mutual funds and individuals who sold off much of the island's uninsured bonds when their ratings were cut to junk, leaving hedge funds and distressed-debt buyers bearing the brunt of the impact. Assured, MBIA's National Public Finance Guarantee Corp. and Ambac Financial Group Inc. guarantee \$27 billion of the U.S. territory's payments, a pledge that's kept those bonds holding steady even as the prices of others tumbled.

The longest-maturing Puerto Rico general obligations backed by Assured, which mature in 2037, traded at an average price of about 100 cents on the dollar on April 7. By contrast, the commonwealth's benchmark bonds due in 2035 last week dropped to as little as 63 cents, the lowest since they were first sold to investors in March 2014.

The insurance companies acted as a similar bulwark following the record bankruptcy of Detroit in 2013, when they stepped in to argue on behalf of bondholders.

With more debt than any state but California and New York, the scale of Puerto Rico's crisis is

unprecedented in the \$3.7 trillion municipal market. It has borrowed nearly nine times as much as Detroit had by the time it turned to court to cut its debt. Puerto Rico Governor Alejandro Garcia Padilla called the commonwealth “insolvent” last week as he signed the law that gives him the power to declare a moratorium on debt payments.

That step, if taken, could last through January 2017 and would likely lead to defaults on general obligations, sales-tax debt and, potentially, its highway securities, according to Standard & Poor’s. Puerto Rico Treasury Secretary Juan Zaragoza last week said there’s “absolutely” no way the government will have funds needed to cover debt bills that come due in July. On Monday, the commonwealth released a revised restructuring proposal that seeks to slash its \$49.3 billion tax-supported debt to as little as \$32.6 billion, a smaller reduction than the cut to \$26.5 billion originally proposed.

S&P, which gives an AA rating to Assured’s units and an AA- to National, has said those ranks are consistent with the companies being able to withstand a wave of Puerto Rico defaults. It doesn’t rate Ambac.

All three companies say they have sufficient funds.

The potential losses from Puerto Rico “are manageable” given Assured’s \$12 billion in claims-paying resources, Robert Tucker, senior managing director at the company, said in a statement. Holders of bonds it insures “can be certain they will continue to receive full payment of scheduled debt service when due,” he said.

Bill Fallon, the chief executive of National, said the company’s \$4.7 billion available to pay claims at the end of 2015 has left it with enough to pay bondholders in full.

“We’re fully capable and liquid to make the payments as required under our policies,” Ambac President Nader Tavakoli said. “If there are defaults on our policies, we will pay them.”

The anticipated losses have been a drag on the companies’ stock prices. Assured shares, which traded as high as \$29.52 in June before Garcia Padilla declared that the island’s debt couldn’t be paid, finished Friday at \$24.01. MBIA has dropped 18 percent since that time to \$7.70, while Ambac declined 37 percent to \$15.15.

Investors can count on insurers to pay them back, but some could struggle with larger-than-expected losses from the commonwealth, said Matt Dalton at Belle Haven Investments. He owns some general obligations that mature July 1 guaranteed by Assured, the only company he relies on for backing.

“It’s like wearing suntan lotion in the hot sun: You just have a safer, more comfortable feeling, because you have the insurance between you and a potential disaster,” said Dalton, chief executive officer of Rye Brook, New York-based Belle Haven, which oversees \$4.2 billion of municipal bonds. “You can still get burned if you stay out in the sun too long, even with UV 50 on, but it won’t send you to the hospital.”

Fitterer at Wells Capital said he’s not only buying insured bonds, but also sticking to shorter-dated debt because of uncertainty around the losses that may be imposed on insurers.

That bet is paying off. Assured-backed general obligations coming due on July 1 traded last week above 100 cents on the dollar, signaling full confidence that both principal and interest will be paid on the maturity date. Those bonds due July 1 without insurance changed hands at 63 cents, which would amount to a yield close to 300 percent.

For Fitterer, Dalton and others holding insured obligations, as the securities come due in the next

few months, they can say something with near-certainty that uninsured bondholders can't. "Yes, they will pay," Fitterer said.

"We're going to get paid on those with insurance, for sure," Dalton said.

Bloomberg Business

by Brian Chappatta

April 11, 2016 — 2:00 AM PDT Updated on April 11, 2016 — 6:43 AM PDT

[S&P's Public Finance Podcast \(Environmental Social and Governance Sector Insights and Illinois Community College Districts\)](#)

In this segment of Extra Credit, Managing Director Geoff Buswick shares his insights on the environmental social and governance sector, and Associate Director Blake Yocom discusses the challenges facing Illinois's community college districts given the state's budget impasse.

[Listen to the Podcast.](#)

Apr. 11, 2016

[Survey: Most Analysts Say Chapter 9 Bankruptcy Taboo.](#)

WASHINGTON - Most municipal bond analysts believe Chapter 9 bankruptcy is taboo for municipalities and should be avoided, according to an analyst survey by PNC Capital Markets LLC.

More than half of the analysts also said Chapter 9 bankruptcy for Puerto Rico would be unfair to holders of the commonwealth's bonds.

The PNC survey, which polled 146 municipal bond credit specialists, 73% of which were buy-side analysts, found that 94% of the participants believed the act of filing for Chapter 9 should be avoided and would make them at the least think twice about buying the issuer's credit.

Eighty percent of the respondents said the overall municipal market thinks the act of filing for bankruptcy is somewhat taboo and 57% said it would be unfair if Puerto Rico was able to access some type of Chapter 9 protection.

The survey found 76% of analysts considered the 2014 Detroit Chapter 9 decision to be unfair to bondholders.

Meanwhile, the Center for Individual Freedom has been stoking fears about a possible Super Chapter 9 solution allowing Puerto Rico to file for bankruptcy protection in a national campaign of television ads that warn viewers that this would lead financially troubled states like Illinois to take similar steps. The group has budgeted about \$2 million for ads, according to one knowledgeable source.

CFIF started the campaign following the House Natural Resources Committee's March 29 release of

draft legislation to help Puerto Rico. The draft bill would not extend bankruptcy protections to the commonwealth but would allow a federally imposed oversight board to file restructuring petitions in federal court on behalf of Puerto Rico if attempts to reach agreements through voluntary restructuring talks with its creditors are unsuccessful.

"As written, [the bill] is an even more dangerous version of the Obama administration's unprecedented Super Chapter 9 proposal, and amounts to a bailout of Puerto Rico on the backs of American savers and retirees," Timothy Lee, CFIF's senior vice president of legal and public affairs said on the group's website. "We want to make sure that every American knows of the disastrous and far-reaching implications of this bill."

But legal experts and muni market participants dispute CFIF's message, saying the U.S. Bankruptcy Code does not permit states to file for bankruptcy protection. It only allows them to authorize their municipalities to file for bankruptcy.

James Spiotto, a managing director at Chapman Strategic Advisors, said no state is asking to file for bankruptcy, as far as he knows, and states even cited their opposition to this in 2011 statements from the National Governors Association and the National Conference of State Legislatures. Additionally, states are dual sovereigns under the Constitution while territories are not, leaving states with more control over their own government, affairs and revenues than territories.

"This resorting to the easy way, namely, a fresh start through a bankruptcy proceeding, would be more costly and less beneficial for the states than other possible solutions," Spiotto said.

PNC in its survey also asked analysts about the top five issues and trends currently facing the municipal market and they overwhelmingly said public pensions were one of the five, with 93% including it on their list.

The next most popular addition to the list was declining investor trust in an issuer's willingness to pay, which 41% of analysts included. While 84% of survey respondents said they have a "high" or "moderate" level of trust toward state and local governments' willingness to honor their obligations, 79% said that level of trust is "lower" or "much lower" than it was five years ago.

Chapter 9 proliferation, infrastructure, and Puerto Rico rounded out the rest of the consensus top five list with 38%, 36%, and 35% of analysts including them, respectively.

Other frequently cited issues were disclosure, the threat to tax exemption, and level of liquidity, each of which were included in over 30% of the surveyed analysts' lists.

The survey also asked respondents to provide insight on their concerns about financially troubled states like Illinois and Pennsylvania. They were asked to assess the general state support of local governments. Ninety-six percent of those surveyed have a "moderate" or "higher" level of concern about Illinois and Pennsylvania's budget delays and 67% said they are questioning those states' abilities to repair their fiscal conditions.

However, 88% said they believe states at least moderately support local governments.

The Bond Buyer

By Jack Casey

April 5, 2016

Assured Guaranty to Acquire CIFG for \$450M.

Assured Guaranty Ltd., the biggest municipal bond insurer, agreed to buy CIFG Holding Inc. for \$450 million in cash, continuing its strategy of acquiring the assets of “legacy” insurers from the financial crisis.

Assured Guaranty said it and its Assured Guaranty Corp. subsidiary entered into the agreement to acquire the parent of financial guaranty insurer CIFG Assurance North America, Inc. The acquisition is expected to be completed mid-2016, subject to receipt of anti-trust and insurance regulatory approvals as well as satisfaction of customary closing conditions. CIFG’s stockholders have already approved the acquisition.

“The acquisition will strengthen Assured Guaranty’s franchise by adding a solid book of business that is consistent with our strategic objectives and will also increase AGC’s capital base and policyholders’ surplus,” Dominic Frederico, president and CEO of Assured, said in a press release.

As part of the transaction, CIFG NA will merge into AGC, which will be the surviving entity. After this merger, the assets and obligations of CIFG NA will become the assets and obligations of AGC, and the bonds insured by CIFG NA will become insured obligations of AGC and, therefore, receive AGC’s financial strength ratings. Additionally, policies associated with the 2009 reinsurance transaction between CIFG NA and AGC that have not been novated to AGC already will become direct obligations of AGC, and the obligations insured by those policies will receive AGC’s financial strength ratings.

“Acquisitions are one of our key strategies, and this is our third acquisition of a legacy bond insurer,” said Frederico.

Assured Guaranty acquired Financial Security Assurance Inc., now Assured Guaranty Municipal Corp., in 2009 and Radian Asset Assurance Inc. last year.

CIFG, a family of financial guaranty companies, was formerly a triple-A monoline insurer. At its height, CIFG was capitalized with nearly \$3 billion in claims-paying resources, providing insurance for investment grade transactions in public finance. As a result of the credit crisis of 2007 and the collapse of the mortgage backed securities market, CIFG was downgraded multiple times by all three rating agencies and eventually had its ratings withdrawn.

The CIFG acquisition is expected to be accretive to Assured Guaranty’s earnings per share, operating shareholders’ equity and adjusted book value. Additionally, the acquisition should enhance the value and market liquidity of the bonds insured by CIFG NA, according to Assured.

As of Dec. 31, CIFG NA had an insured portfolio of \$5.6 billion of net par and approximately \$637 million of statutory capital. Assured Guaranty currently estimates the transaction will increase its statutory capital in 2016 by approximately \$300 million to \$325 million.

The Bond Buyer

By Aaron Weitzman

April 13, 2016

Fleeting Opportunity Seen as Swap Index Spikes.

A combination of pricing pressure due to seasonal weakness, new regulations on money market funds, and the scarcity of short-term paper is creating a unique buying opportunity in one of the municipal market's most actively-used benchmarks for swap transactions.

After 19 consecutive weeks unchanged at 0.01%, the rate on the weekly reset municipal swap index overseen by the Securities Industry & Financial Markets Association spiked in March and currently remains at 0.39% as of April 13.

The 52-week range is 0.01% to 0.40%, according to SIFMA.org. Analysts said it's the first such opportunity to boost yield on the short end of the curve in two years.

"This is a technical condition of the market that acts in favor of investors because it pushes rates higher, but they won't stay there very long," said Phil Fischer, managing director of credit research at Bank of America Merrill Lynch & Co.

Money market fund rules passed July 2014 by the Securities and Exchange Commission triggered \$20 billion of outflows and created a structural "disequilibrium" that's now affecting the market, Fischer said.

The most critical of the regulatory changes involve floating net asset value and fees and gates amendments, many of which will be implemented on Oct. 14, and some of which go live on April 14. Some of the minor tweaks have already been implemented.

This year, the SIFMA municipal swap index rate has surged from 0.01% to 0.40% in a matter of weeks, Fischer said.

"We normally have weak technicals through tax time caused by outflows," he said. "But we are not supposed to have seven-day muni rates at 0.01% when comparable taxable rates are on the order of 0.40% basis points."

Created in 1992 by SIFMA to both accurately reflect activity and boost liquidity in the VRDO market, the index is comprised of hundreds of actual issues that represent the universe of VRDO securities.

Fischer said the index is gospel to the MMF industry because it provides the average rate for several hundred VRDOs that purchased aggressively by money market funds.

Issuers typically sell long-term bonds that - depending on the liquidity and put features - allow them to reset as weekly interest rate swaps at rates determined by the level of the SIFMA index.

Prior to April 13, the rate of the index spiked to as high as 0.40% on March 30. It was calculated at 0.29%, 0.13%, 0.06%, and 0.02% in the prior four weeks before March 30 after remaining unchanged at 0.01% consecutively each week from Oct. 21, 2015 to March 2 when it crept up to 0.02%.

The rate had been at 0.02% for the previous 12 consecutive weeks, and prior to that it largely hovered under 0.10% dating back to August 20, 2014, according to SIFMA.org data.

Investors who are seeking respite from the relatively low absolute yields in the municipal market, yet want to remain defensive to hedge against potential interest rate volatility, can reap the best of

both worlds as a result of the rare, higher than usual short-term yields, analysts said.

They describe the price spike as an anomaly because of its arrival and availability amid individual income tax season, the debut of new regulations imposed on municipal money market funds later this year, and a scarcity of short-term paper, which has been largely declining since 2008.

"It's a good opportunity for people who want to invest or reinvest at the higher rates" before the normalization of supply and demand at the short end of the curve in month or two ahead of the June 1 and July 1 rollover season, Fischer said.

Others agreed that the swift increase in the SIFMA municipal swap index is a positive for yield-starved investors, though they said its timing is uncharacteristic.

"This is a good event for investors ... they are collecting more interest," said Mike Craft, managing director of credit at Lumesis, Inc., a financial technology company focused on providing business efficiency, regulatory and data services to the municipal bond marketplace.

He said even though the higher-than-usual spike in the SIFMA index is occurring earlier this year, it is still a positive market event given the overall low absolute yields.

"In previous years, the tax time spike came later, usually the middle of April," Craft said. "If taxpayers own MMFs and owe the IRS, they tend to wait to file, redeem funds, and pay near the deadline."

Craft isn't certain if the anomaly is a structural shift due to the recent money market fund reform, but if so, he said it can shrink that market further, not to mention possible unknown impacts in the municipal market in the future.

The MMF reform requires a floating NAV for institutional prime money market funds, and allow MMFs to impose a liquidity fee of up to 2%, or temporarily suspend redemptions – also known as a gate.

These fees and gates give non-government money market fund boards new tools to address runs and stem heavy redemptions and avoid the contagion that occurred in the 2008 financial crisis.

While retail prime and retail municipal money market funds are able to continue transacting at a stable \$1.00 NAV under the reform, this option is not available to institutional investors. They will be eligible to use government money market funds and institutional, non-government money market funds, which will have a floating four-decimal NAV.

Fischer said the opportunity to earn higher yields is likely to be short-lived and investors should take advantage of the spike in rates now rather than waiting.

"It's an anomaly but it's going to head back toward the equilibrium in a month or two," Fischer predicted.

Issuance of VRDO paper has contracted to \$1 billion so far this year, down from the \$116 billion in all of 2008. Austerity at the state and local levels has contributed to the decline as the outstanding volume of traditional notes maturing in less than 13 months has dropped to \$30 billion from \$100 billion in 2002, according to Fischer.

"We don't have a lot of short-term paper directly as notes or synthetic VRDNs and what that means is that the municipal market is chronically short of enough short-term paper," Fischer said. "As

states get more surplus money the need to borrow is less.”

Part of the decline has stemmed from inefficiencies and market changes, he said.

“The cost of these bank facilities has gone way up and the issuers found it cheaper to place some of that as bank loans,” he said.

That further compounds a supply-demand imbalance already affecting the short-term market, according to Fischer.

“That’s why you see that the municipal market is always upward sloping and the very short end has lots and lots of demand from individuals and institutions and not a lot of supply,” he added.

That supply-demand imbalance is what kept the SIFMA index at 0.01% since October of 2015, Fischer noted.

He said investors were willing to accept almost no return in exchange for the low risk of the Federal Reserve Board suddenly raising short-term rates before December 2015.

Fischer said the bias toward higher short-term rates, in part a result of the implementation of these regulations, could last through the end of April. Afterward, there could be a new precedent once the impacts of the new MMF regulations sink in and tax season passes, he said.

Typically, the rates on the SIFMA index have been equivalent to 70% of one month of the London Interbank Offered Rate, or LIBOR.

“To have SIFMA index at 0.01% for this length of time is an extreme anomaly,” despite the seasonal effects, regulatory changes, and ongoing shortage of short-term municipal paper, Fischer said.

The Bond Buyer

By Christine Albano

April 14, 2016

[Why Bond Trustees Are Often Frustrated, Powerless in Today's Debt Environment.](#)

PHOENIX — Bond trustees are proving to have less power than some investors expect as debt distress has become a more persistent concern for municipal bond investors.

Bond trustees are responsible for ensuring that the bond issue is administered according to the deal structure as agreed upon by the issuer and other members of the financing team. While the underwriter, bond counsel, and other members of the team generally move on after closing, the trustee remains involved with the bonds for as many years as they remain outstanding.

“We’re the only professional that stays in the transaction from the beginning to the end,” said David Lonibos, managing director for U.S. Not For Profit at BNY Mellon in New York. “The role of the trustee is pretty simple,” Lonibos said. “We look out for the bondholder.”

But David Fernández, a shareholder at Buchanan Ingersoll & Rooney in New York and Philadelphia,

said that trustees have become marginalized to the point that their ability to help structure bond documents and act in the event of a default is limited.

“They’ve been beaten into submission,” Fernández said.

The role of the trustee is spelled out in an indenture or resolution, and their conduct is not governed by the Municipal Securities Rulemaking Board the way the conduct of underwriters and municipal advisors is. Corporate bond trustees are subject to the Trust Indenture Act of 1939, but that law includes a specific exemption for muni bonds. That law requires all corporate bond issues over \$5 million to be governed by a formal indenture and administered by a trustee, but a majority of muni bond issuances of size have trustees despite the lack of a federal law mandating it. According to data from Thomson Reuters about \$2.1 trillion of muni bond issuances since 2006 have had trustees, of the slightly less than \$3.8 trillion total. The two biggest trustee banks in the muni world by far are BNY Mellon and U.S. Bank, which combine to own more than 39% of the market share.

Terry McRoberts, executive vice president of Global Corporate Trust Services at U.S. Bank, said that he has noticed a trend towards issuers choosing and sticking with a trustee for all their work.

“We have seen more bias by issuers to use one trustee rather than to spread it around,” McRoberts said. He said his bank views public finance as “very local,” and that trust account managers may be handling a certain issuer for many years.

“They have a relationship,” McRoberts said.

While the trustee’s duties are primarily ministerial, including duties like collecting and disbursing payments and document review, it is their roles when issues become distressed and default that has drawn some increased attention as the industry has increasingly grappled with the implications of distress due to the ongoing struggles of Puerto Rico and a few high-profile municipal bankruptcies. The trustee is supposed to act as an agent for the bondholders, enforcing their rights under the indenture and attempting to get them their money. Both McRoberts and Lonibos said their banks have separate groups that administer an issue once it defaults, and Lonibos said that the industry took default among muni bonds lightly for years because of its relative rarity compared to corporates.

“A lot of us have been guilty of a ‘well, that will never happen’ attitude,” he said.

Investors have sometimes expressed frustration when their trustee doesn’t seem to be acting to protect their rights, or seems to be acting too slowly. Last month, a major investor in several defaulted Florida housing bond issuances said its trustee, Bank of Oklahoma Financial, was not moving quickly enough to secure the firm’s rights. BOKF maintained that it was taking action.

“The role of the trustee is finally getting some attention,” Fernández said. “They are the most ignored member of the deal team.”

Fernández, a longtime trustee counsel, said that trustees are generally selected by issuers via a competitive bidding process that results in very low fees for their work and are often brought to the table after all the bond documents, including the crucial indenture that governs them, have already been written.

Fernández said this treatment of a trustee can result in simply a “cursory” review of the documents that later leads to confusion about what is expected of them. Fernández added that when a trustee is viewed as being asleep at the wheel, it is often the case that they were brought in late and that any suggestions the trustee firm had about what to put in the indenture were ignored.

"They've basically become the orphan stepchild of the bond business," he said.

While bond counsel and the underwriter generally walk away from a sizable bond deal with six-figure or larger earnings to show for it, trustees get only a nominal administrative fee of some \$1,500 in many cases, Fernández said. And once a bond issue does default, he said, the trustee may have much more limited power to act than one might think.

"The actions that they take are irrevocable," Fernández said. "Once that money is out the door, it's gone. It's not coming back. Especially in a situation like Puerto Rico or a distressed debt situation where that money is going to get sucked into a vacuum."

Because of those implications, Fernández said, trustees that aren't able to garner agreement from 100% of bondholders about what actions to take in a default scenario may be more inclined to just wait for a court order to decide what they should do.

"They've become a reactive institution, not a proactive institution," said Fernández.

Lonibos said what a trustee will do is based on the interpretation of the indenture, and at his firm is done by a group who was not previously involved with the deal.

"Trustees do their best to interpret the document," he said.

The Bond Buyer

By Kyle Glazier

April 11, 2016

[Puerto Rico Fight Is About Setting Precedents, Bond Insurer Says.](#)

As the debate over repaying Puerto Rico's \$70 billion of debt reaches a fever pitch, bond insurer National Public Finance Guarantee Corp. says it's keeping in mind broader implications for the municipal market.

The unit of MBIA Inc. is on the hook for about \$8.9 billion in Puerto Rico debt-service payments, with exposure to the commonwealth's general obligations, sales-tax debt, highways securities and others. The bonds backed by the government's full faith and credit, which would recover 80 percent under the island's latest proposal, may prove the most contentious because they're constitutionally guaranteed and losses could set a benchmark for future distressed localities, National Chief Executive Officer Bill Fallon said.

"We need to do what's best for our shareholders — we do though want to make sure that anything that's done, to the extent it sets a precedent for the market, it's done in the right way," Fallon said in an interview at Bloomberg's New York headquarters.

"The issue on the G.O.s is a big one for the marketplace, because that is meant to be full faith and credit," Fallon said. "If all of a sudden they take a haircut, yes, they made it a lower haircut than anything else, but they haven't really said they take priority yet. This is one that's going to take a while to play out."

Sacrosanct Pledge?

Questions about the sanctity of the general-obligation pledge grew after Detroit filed its record municipal bankruptcy in 2013. Those creditors eventually settled on a 74 percent recovery. National backed some of those securities.

The difference between the two distressed situations is the magnitude of the debt. Detroit had \$388 million of unlimited-tax general obligations, while Puerto Rico has issued \$13 billion of the securities. Its constitution says revenue must be first used to pay public debt before other disbursements can be made.

Puerto Rico instead is seeking to impose losses on all types of bonds. In a revised debt-restructuring proposal released Monday, it offers a combined 74 percent recovery on general obligations and commonwealth-backed debt, up from 72 percent in its first plan that it unveiled Feb. 1. Sales-tax bonds, called Cofinas by their Spanish acronym, would get 57 percent, up from 49 percent.

Just days earlier, investors holding almost \$5 billion of Puerto Rico general-obligation bonds released their own plan that would defer principal repayments for five years through a consensual exchange offer and allow the commonwealth to make an \$805 million payment on July 1. National's rival Assured Guaranty Ltd. on Monday joined in support of the proposal.

Puerto Rico said it wouldn't leave money to pay any other creditors.

When it comes to a recovery rate, "each time it keeps going up, so they're going in the right direction," Fallon said. "But I'm not sure people are really that inclined to start talking about what the haircuts should be, because there's not good information."

Bloomberg Business

by Brian Chappatta

April 12, 2016 — 9:09 AM PDT

[As Muni-Bond Crises Build, Pensioner Wins Show Investors' Peril.](#)

Puerto Rico, Atlantic City and Chicago school district bondholders have reason to fear a fight in court if the ailing governments collapse financially: recent cases show that when municipalities go broke, investors lose when pitted against municipal retirees.

The latest example is San Bernardino, California, which saddled bondholders with a 60 percent loss while keeping retirement benefits intact under a settlement last month aimed at ending its nearly four years in bankruptcy. That's in line with the outcome of the local-government bankruptcies filed since the onset of the Great Recession, all but one of which sheltered pensioners from the deeper cuts extracted from investors who bought their debt.

"The more cases that come to light like this in favor of pensioners, the odds of breaking those precedents become lower and lower," said Howard Cure, director of municipal research in New York at Evercore Wealth Management, which oversees \$6.2 billion of assets.

When Governments Go Bankrupt, Bondholders Bear the Cost

Pensions checks, a retiree lifeline, take priority when cash runs out



The \$3.7 trillion municipal market is contending with an new bout of unprecedented, if circumscribed, round of financial distress by governments struggling to cover their debts to bondholders and retirees.

As Puerto Rico veers toward record-setting defaults, bondholders have lobbied Congress to block giving the island power to file for bankruptcy, though House Republicans have proposed allowing a court-supervised restructuring. In Illinois, Republican Governor Bruce Rauner has pushed for letting Chicago's school system file for Chapter 9 as it reels from ballooning pension obligations that officials shortchanged for years, while in New Jersey lawmakers are fighting over how to rescue Atlantic City that may involve bondholder losses.

The outcome in San Bernardino shows why bondholders should be wary of distressed local governments that can petition to have debts reduced in court, according to BlackRock Inc., the world's largest money manager.

"Pensions are faring far better than other creditors under Chapter 9," analysts led by Peter Hayes, BlackRock's head of municipal bonds, wrote in an note Monday. "This reinforces the view that bondholders need to be extremely cautious dealing with distressed municipalities."

San Bernardino, a city of 215,000 residents about 60 miles (96 kilometers) east of Los Angeles, was among the municipal bankruptcies that followed the onset of the 18-month recession at the end of 2007, which caused tax collections to tumble. Contending with costly fire and police contracts, the community filed in August 2012.

Last month, it announced a deal with Commerzbank Finance & Covered Bond SA and bond insurer Ambac Assurance Corp., the holder and guarantor of about \$96 million in pension-obligation bonds, that wrote down the debt by 60 percent. City officials argued they had little recourse: If forced to cover the full amount to bondholders, they wouldn't be able to fully fund promised pension benefits, they said in a court filing last month. A judge must approve the city's exit from court protection.

Strong Support

Another California city, Stockton, also continued full pension payments at the expense of bondholders, even though a judge ruled that it could have tried to reduce that obligation, too. The city argued that fight would take too long and could jeopardize the welfare of retirees.

"Pensions enjoy a pretty strong level of political support," said Thomas Aaron, senior analyst at

Moody's Investors Service in Chicago.

San Bernardino's workforce didn't emerge unscathed, with the city eliminating retiree health-care subsidies and requiring employees to put more of their pay into the pension system. But it didn't cut pension benefits. It's also coping with a decision in 2012 to cease payments into the California Public Employees' Retirement System, which proved costly by triggering a \$2 million penalty and interest of 7.5 percent on the \$13.5 million in skipped obligations.

With benefits intact, the community's pension contributions are set to grow from \$19 million in the next fiscal year to as much as \$44 million by 2030. That compares with a general-fund budget of \$128 million this year.

In every recent bankruptcy nationwide except for Central Falls, Rhode Island, pensioners have fared better than bondholders, according to Moody's. In Detroit's, the biggest, pensioners recovered about 82 percent of what they were owed, compared with 25 percent for bondholders, according to the rating company.

Given the discretion given to cities to draft their plans out of bankruptcy, "this trend should not reverse itself," said Bill Bonawitz, director of municipal research in Philadelphia at PNC Capital Advisors, which oversees \$6.5 billion in municipal bonds.

Bloomberg Business

by Romy Varghese

April 12, 2016 — 2:00 AM PDT Updated on April 12, 2016 — 6:38 AM PDT

[GASB Issues Pension Guidance Addressing Issues Raised by Stakeholders During Implementation.](#)

The GASB [recently issued](#) guidance addressing practice issues raised by stakeholders during implementation of the Board's pension accounting and financial reporting standards for state and local governments.

[GASB Statement No. 82, *Pension Issues*](#), addresses:

- Presentation of payroll-related measures in required supplementary information
- Selection of assumptions and the treatment of deviations from guidance in Actuarial Standards of Practice for financial reporting purposes, and
- Classification of payments made by employers to satisfy plan member contribution requirements.

The Statement is designed to improve consistency in the application of the pension standards by clarifying or amending related areas of existing guidance.

[Moody's Report Tracks P3 Credit Risk, Confidence In the U.S., Canada and Europe.](#)

Interest in using public-private partnerships to develop public projects is slowly growing in the United States, remaining steady in Canada but declining in Europe, Moody's Investors Service has found. The ratings agency also concluded that variations in approaches to financing P3s from one region to the next can affect P3 credit ratings.

Moody's publicly rated 10 Canadian P3s, seven in Europe and three in the United States, in a new report, ([paywall](#)) which "illustrates a return to growth in demand for the asset class," [Moody's](#) said.

However, different financing approaches can affect the perceived creditworthiness of projects, the agency pointed out

"We've seen some similarities across the regions in how P3s structure their credit profiles and use insurance projects to mitigate risk. But overall, local differences remain very important and lead to material differences between projects from a credit perspective," said Catherine Deluz, Moody's senior vice president.

In Canada and Europe, private partners decide what level of bonding is required, based on the project's risks and the lender's requirements. Many U.S. state governments, on the other hand, require private partners to post material performance bonds to support P3 obligations.

Moody's also found that five projects in the United States and Europe used a deferred draw bond to mitigate the cost of holding an asset that is associated with most bond funding and the agency expects to see more use of these bonds in the months ahead.

Moody's noted that 83 percent of recently rated P3s have received government funding during the construction phase and that an increasing number of municipalities and local authorities are procuring projects through P3s.

Project risks Moody's attributes to government partners include the potential for an agency that is making availability payments to default or make late payments and potential financial uncertainty governments that rely on gas and oil revenues or financial institutions with large oil and gas portfolios face.

The weakening of debt structures, particularly in North America, is yet another risk the report singled out. However, all of the above-mentioned weakening trends may be offset by increased confidence in P3s, based in part on their low level of default, the agency concluded.

NCPPP

April 14, 2016

[What Is Lost When a State Takes Over a City.](#)

The ruining of Flint's water after the state stepped in holds lessons — and difficult questions — for governments everywhere.

The Flint water crisis has captured national attention as a spectacular government failure. A Michigan city was poisoned through public management, with breakdowns at the local, state and federal levels. But in this case, the local and state levels were the same, since Flint was then controlled by state-appointed emergency managers (EMs) with extraordinary powers. Now this

aggressive state approach to local governance has been identified as a key factor in the crisis by Gov. Rick Snyder's Flint Water Advisory Task Force in its [final report](#).

While other factors were identified too, including oversight failure by the U.S. Environmental Protection Agency, the task force report's focus on the EM law is sure to drive mounting pressure for reform. As other states try to help their own struggling communities, Michigan's laboratory of democracy offers important lessons. And it raises a number of questions for which there are no simple answers.

Since the U.S. Constitution does not mention local government, states are empowered to create local governments and endow them with certain powers. Michigan's approach to local government finance is among the most restrictive in the nation, in more ways than one. On the front end, the state cut revenue sharing to local governments more than any other state between 2002 and 2012. Michigan's constitution also places severe caps on local government's ability to raise funds locally. Indeed, [recent research](#) at Michigan State University concludes that, along with state-imposed spending pressures, Michigan's approach to funding local government "incubates" fiscal stress.

Meanwhile, on the back end, Michigan's emergency-manager law is the most aggressive in the nation in terms of state takeovers of local government. Michigan's current law allows an EM to set aside all decision-making power of local elected officials. EMs can also terminate labor contracts, sell off a jurisdiction's assets, and more. In addition to Flint, in recent years Michigan EMs have controlled Benton Harbor, Detroit, Hamtramck, Pontiac and other cities. School districts also have had EMs in charge.

The ability of an EM to completely sideline local elected officials has led to charges that the law is undemocratic, since the voters' choice for mayor and council members can be effectively voided. Gov. Snyder — who championed the EM law — argues that since he was elected by the citizens and emergency managers ultimately report to him, this is still democratic governance, if less direct.

Michigan's voters aren't so sure about that. They overturned a previous and similar version of the law in the fall of 2012, but the state responded by rushing the current, slightly modified, version through a lame-duck session just weeks later.

But while citizens opposed the law, a [2012 Michigan Public Policy Survey](#) of local-government leaders conducted by the University of Michigan's Center for Local, State and Urban Policy found some surprising support for the state's aggressive approach. Among those who knew of the law, 38 percent supported it while 30 percent opposed it. Perhaps most surprising, the greatest support (68 percent) came in the state's largest jurisdictions, the very places where EMs are most likely to be installed.

One key feature of the law — the EM's power to modify or terminate collective-bargaining agreements with public employees — hints at why leaders in the biggest cities are more likely to support it. In the smallest jurisdictions, 38 percent support this feature of the law, but these jurisdictions are the least likely to have unions. By comparison, in the state's largest jurisdictions, where employee unions are common, 74 percent of local leaders support an EM's ability to overturn union contracts. This may allow local leaders to play the good cop while the state and EM play the bad cop in dealing with union contracts.

Back to the Flint water crisis. Gov. Snyder's task force found that EMs made the decision to switch to the Flint River (and to not switch back later to Detroit water when pushed to do so by local leaders and citizens), and it has called for changes. The task force notes that when an EM is installed, the local democratic system of checks and balances is lost.

What matters most here? In retrospect, that's easy: the health, safety, and welfare of the citizens, precisely what the state of Michigan failed to protect. But beyond that, what is most important? The right of voters to elect their own local leaders? Local governments' fiscal health and sustainability? Checks and balances in governance? The right of the state to control its local governments when things have gotten too far off-track?

These are tough questions, with no easy answers. Michigan has been a laboratory testing these issues, and it has made far-reaching mistakes in the process. Across the country, other government leaders owe it to their own citizens to learn the lessons of Flint.

GOVERNING.COM

BY TOM IVACKO | APRIL 13, 2016

Slow and Steady Is Sexy Again: Investors Return to Munis.

NEW YORK — Boring? Give me more of that!

The municipal-bond market looks to be regaining its reputation for delivering reliable if unsexy returns, following several big swings since the financial crisis. It's remained sturdy in recent months, even as stocks and other types of bonds have jerked up and down. That has investors, mostly high income earners, once again pouring in dollars in search of safety.

Municipal bonds are issued by states and local governments to raise money to build the school down the street or expand the local sewer system. In exchange for funding projects meant to be good for the community, investors generally do not have to pay federal income taxes on the interest payments they receive. In some cases, they're also exempt from state and local taxes.

The largest municipal bond fund returned 2.9 percent last year, more than the largest stock fund's 0.3 percent. More importantly for twitchy investors, Vanguard's Intermediate-Term Tax-Exempt fund is on pace for its 10th straight month without a loss.

Demand has been strong enough that roughly \$16.5 billion has flowed into municipal-bond mutual funds over the last year, according to the Investment Company Institute.

Contrast that with the \$73.6 billion that left taxable bond mutual funds, in large part because investors were fleeing high-yield funds on worries about their riskiness. Stock funds had even faster rates of withdrawals.

Just remember that the reason for muni bonds' recent popularity is precisely because they're boring. Don't come in with expectations of getting rich quickly. Yields are low, which cap future returns, and their strong performance last year and so far in 2016 has pushed yields even lower.

"I don't think there's a lot of downside, but the upside is limited too," says Guy Davidson, director of municipal bond management at AllianceBernstein. "Muni funds can offer stability and income in a volatile world, but I don't think you should be preaching for excitement given these yields at the moment."

A DIFFERENT STRUCTURE

Yields are low for muni bonds relative to their history, and they can also be lower than taxable bonds with a similar maturity and credit rating. That's traditionally been the case because muni bonds' income is free of taxes.

Top income earners have a federal tax rate of nearly 40 percent, which means a taxable bond yielding 3 percent would generate the same spending power after taxes as a muni bond yielding just 1.8 percent. Many websites have online calculators that help investors figure out the "tax-equivalent" yield of their bond funds.

That's also why investors hold muni bonds in taxable accounts. If they were in a 401(k) or another tax-deferred account, their tax advantage would be wasted.

PAST SHOCKS

The muni bond market has historically been relatively sleepy. Then the financial crisis hit.

Municipal bond funds held up better than most investments, but the largest category of them still lost an average of 2.3 percent in 2008. Returns rocketed higher the next year, but another shock came in late 2010 and early 2011. That's when a high-profile prediction for a wave of municipal defaults sent investors running for the exits.

The default wave never materialized, but panic set in again in 2013 when worries spiked that interest rates could rise faster than expected. Since then, the muni bond market has dealt with more scares, like the recent debt crisis in Puerto Rico.

STAYING CHOOSY

It's not just Puerto Rico that has raised concerns. Investors are worried about Chicago and areas that have big pension obligations. Governments heavily reliant on revenue from the oil industry are also under pressure, following the collapse in the price of crude. The fear is that if local tax revenue craters, it will be difficult for the municipality to pay back investors.

But fund managers say the market sees these as isolated trouble spots. In the rest of the country, tax revenue is on the upswing due to the stronger economy. And many local governments slashed their expenses and held off on issuing debt following the financial crisis.

"Throwing out Chicago and Puerto Rico, muni credit is kind of as good as it's ever been," says Nick Venditti, portfolio manager at Thornburg Investment management. "It's very easy for a muni bond buyer to come into the market and avoid the Chicagos and Puerto Ricos and find more fundamentally strong credits."

POTENTIAL RISKS

Like any bond fund, a municipal-bond fund will fall in price as interest rates rise. So far, rates have remained low, but most expect them to eventually rise. If it happens slowly enough, the bigger income payments that higher rates would bring could offset price drops.

When assessing the market, muni fund managers also look at how much supply and demand exists for tax-free bonds. Supply hasn't grown as much as in the past, because local governments have been slow to borrow since the financial crisis.

Managers see the strength of demand as the bigger potential threat to future returns. The municipal-bond market is dominated by individual investors, rather than big institutional investors

or hedge funds, and they have shown in the past that they can be quick to sell.

For now, muni bonds' steady returns mean demand has remained consistent and strong. Managers say they see few reasons for that to change, at least in the near term.

"I am expecting more of the same," says Regina Shafer, who runs municipal bond funds at USAA. "I think investors appreciate the stable market that municipals bring. We're steady as she goes."

By THE ASSOCIATED PRESS

APRIL 14, 2016, 4:41 P.M. E.D.T.

Credit Ratings Don't Always Tell The Whole Story.

Dusty Self: RidgeWorth is a multi boutique global asset management firm with about \$37 billion in assets under management. We offer 28 different mutual funds, both equity and fixed income. At RidgeWorth SEIX, We manage approximately \$1.5 billion in the investment grade tax-exempt space. We have three state-specific funds, and we have three national funds that cover the spectrum of the maturity schedule including a long fund, an intermediate fund, and the RidgeWorth Seix Short-Term Municipal Bond Fund (SMMAX), which I manage. This fund has an average maturity of three years or less. But our common strategy across all of these products is that we're active total return managers.

That means we believe in investing in undervalued securities, or sectors that have improving fundamentals, because we're looking for principal appreciation. So buy and hold is fine if you never have to sell before maturity, but we think that investors are leaving too much on the table, and that your allocation to municipal should work harder for you. It's not just about buying at the right price. It's also about knowing when to get out. So identifying securities that are overvalued, or sectors that may have declining fundamentals. Looking for those yellow flags helps you limit your downside risk — and that's our emphasis.

Our investment strategy has been in place for more than 20 years. It centers around three main principals. We believe that 1) interest rates cannot be forecast with any certainty, 2) inefficiencies in the municipal market create investment opportunities, and 3) investors should look beyond yield, to look at quality.

The municipal market has been in this evolution since the credit crisis, where it was this homogeneous mostly-insured AAA-rated market, to now becoming a credit-driven market that has more than 60,000 issuers. So credits and issuers with the same rating just do not have the same underlying fundamentals. And there's even differences between states. Some states have legislation to protect holders of their general obligation bonds, and others do not. So when you're trying to value — or appropriately value — a security, you have to consider all of those things that go into determining value.

So let me give you an example of two states: California and Pennsylvania. And they're both rated Aa3 by Moody's and AA- by S&P. California has legislation in place that provides for the legal protection of its general obligation bond holders. It's got a budget surplus, a rainy day fund, pension plans that are funded 75% to 80%, and a growing and diversified economy. Conversely though, you have Pennsylvania, which has a significantly under-funded pension plan at 51%. It's had a budget impasse for the past eight months and is considering diverting gaming revenue into the general fund

so it can make those pension payments. And it provides no legislative protection for its general obligation bond holders.

You have two states that are rated the same, but on very different trajectories that offer very different yields. So we don't think that you should be just chasing yield. When you have 50 different states with their own constitutions, their own legislatures, their own laws, their own political risk, in our minds you have a lot of opportunity but for an individual there is more risk than they realize. In general, the underlying strength of the municipal market, we think, is a reflection of the moderately growing economy.

As a result, defaults remain relatively low and we're seeing upgrades outpacing downgrades for the first time in seven years. So this safety and this low correlation with other asset classes really make a strong case to invest in municipal bonds. But you need to be extremely careful, and make sure that you understand the relative value and what is behind the bonds that you're purchasing.

Wally Forbes: Interesting perspective. How about some examples?

Self: Beyond the differences between the states, we're very concerned about local general obligations. We continue to see that pensioners are being favored over bond holders. And when you see these legacy liabilities, that pensions and OPEB (other post-employment benefit) obligations are crowding out infrastructure spending at the state level, that is the start of a bad situation.

When that happens, what you're doing is that you are pitting pensioners against other constituents. Looking forward, should we slip into a recession and states again run into larger budget issues, the state is going to force down to the local level some of what it can't pay. They're going to pass that down to the local level and make it the local government's responsibility. So we're really concerned about the impact of OPEB and pension liabilities on local general obligation sector, and how they're going to be able to respond in the upcoming fiscal years.

Forbes: That sounds like it could be a big trap.

Self: It could be very tricky. We've seen many states that used the political cover of the recession to make very difficult fiscal policy changes. And they seem to be doing okay. But then there are other states that really did not get out in front of some of their issues, and now it's going to be time to pay the piper.

Geographically, we look throughout the country, because we're looking for relative value. So we're looking for opportunities of something that's trading cheap, historically, or something that's trading expensive. We're constantly looking throughout the country, and what's available in the municipal market. Geographically, we continue to like California, Florida, and the western states. They all have strong, stable, and diversified economies. And you continue to see growth in the migration into those Sunbelt warmer states.

Another sector we like is transportation. And that encompasses a couple of different mini-sectors. We like airports. The larger hubs, where passenger traffic continues to increase and in general lower oil has been a benefit. But we're going to bifurcate that area a little bit. We're going to stay away from the regional hubs where maybe it's not as easy for them to turn a profit because of a decline in passenger traffic or a carrier has pulled out.

Similarly, seaports. Even with the expansion of the Panama Canal, we continue to see improved traffic in the seaports. And we still like toll roads. Even though we realize that toll roads are tied to the economy, we're still watching them. So far, they're fundamentally sound. And we've seen an

increase in issuance with the private-public partnerships and view that as a credit positive for the toll road sector. We think it is going to provide some improved relative value and principal appreciation going forward.

Forbes: Are there any particular issues that you think are especially attractive and can you tell people how to go ahead and buy them?

Self: The things that we like to take a look at are issues that somewhat get mispriced. One example, we like Chicago Airport. When they came out with a new bond deal last fall it was priced cheap from a relative value perspective, it had a little bit of taint, because of the name. But it's a separate entity from the city. So they have little to no pension exposure. They've seen the increase in passenger traffic. And just because they had the Chicago name, we saw them trade a little bit cheaper.

Since then, more news has gotten out. People are learning who's really behind, or what is really behind the bonds that they own. And we've seen the spread on the Chicago bonds improve. Similarly, we like the Port of Seattle in Washington, where it's a dual backing bond that means 70% of the revenue comes from the airport, and 30% comes from the seaport. So any sort of bond where you have multiple revenue streams, or you have confirmed revenue streams, where you know exactly how that bond is going to get paid, those are the things that we look for. We want that certainty.

Forbes: That sounds very interesting, and makes a lot of sense. As an individual investor, how do you go about getting to some of these kinds of opportunities? Just do it through your broker?

Self: For a total return strategy an investor would be best served in a mutual fund like the RidgeWorth Seix Funds. Remember we are looking throughout the country for securities that are mispriced and undervalued every day. It could be very difficult to do it through your broker. Available to the public is the emma.msrb.org website, which will include some disclosures and information on municipal securities that you can read. You can also ask your broker about where the revenue stream payments are coming from, and get some background information but the level of disclosure in the municipal market is unlike any other market. It can be a difficult and lengthy process to get information.

Forbes: And that is a website that has municipal bonds listed on it, or what?

Self: It's just information. It's access to the municipal market that has information about disclosures. It also has some trading information, current trading information on securities.

Forbes: How does one tell a better security from a less-good security? Can you do that on the website?

Self: It will help you find comparative price discovery and can help you sort through similar structures, similar maturities, similar credit ratings but remember my example of California and Pennsylvania, credit ratings don't always tell the whole story. These are the types of things that we're looking at when we are purchasing for our mutual funds. We have a credit team with over 28 years of experience in place that spends their time doing analysis. For the individual investor, it is a lot of information to have to filter through and then try to compare and make an informed decision.

Forbes: This has been a different investment area than we usually cover and I'm sure it will be of interest to our readers at this time when good income is a little hard to get.

Self: That is so true, in today's market good income is hard to come by.

Forbes: Dusty, thank you for taking the time to join us.

Self: Thank you, Wally.

AN INTERVIEW WITH

Dusty Lee Self

Director and Portfolio Manager Seix Investment Advisors LLC, RidgeWorth Investments

Wallace Forbes, Contributor

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Opinions expressed by Forbes Contributors are their own.

Teachers' Required Pension Contributions Are Less Fair Than Union Fees.

Though the Supreme Court's four-to-four deadlock in *Friedrichs v. California Teachers Association* on Tuesday upheld the requirement that nonunion members pay union fees, it raised new doubts about the fairness of a practice conservative activists have fought for decades. But a more insidious—and lesser known—injustice faces teachers in California and around the nation: they must contribute a substantial share of their salaries to pension plans that deny them a fair return.

In the Supreme Court case, nonunion California public school teachers claimed that having to pay union fees, mandated in California and more than 20 other states, infringes on their First Amendment right to free speech. The union countered that the fees only support its collective bargaining activities, which benefit all teachers, including nonunion members. The court's deadlock means that mandatory payments that support collective bargaining, which the Supreme Court upheld in 1977, may continue.

Pension contributions exceed union fees

The lead plaintiff, Rebecca Friedrichs, says she is forced to pay about \$600 a year in union fees. But like all California public school teachers, she must also pay 9.2 percent of her salary to the California State Teachers' Retirement System. For a teacher earning \$78,000 a year, the average in Friedrichs' Savanna school district, these contributions amount to nearly \$7,200 a year, about 12 times her required union fees.

Teachers like Friedrichs may feel they get nothing in return for their union fees, but surely they benefit from their retirement contributions, right?

The payback rarely exceeds teachers' total contributions

Newly hired California teachers can expect an annual pension equal to 2.4 percent of their final salary for every year they teach if they retire after age 65. For a 40-year veteran, that amounts to 96 percent of her final salary, or about \$90,000 a year in inflation-adjusted terms. That payment stream will be worth more than \$1 million when she turns 65.

That's a good deal, but relatively few California teachers remain in state classrooms long enough to collect such a generous pension. Only half of all newly hired teachers complete more than 11 years of service, and only a quarter complete more than 20 years of service. And those with less service receive much smaller pensions.

A 25-year-old teacher hired today would receive a future annual pension of only \$12,000 if she teaches for 20 years or \$3,500 if she teaches for 10 years. That teacher would have to remain employed for at least 28 years to collect benefits worth more than the required plan contributions. Teachers who stop teaching earlier lose money in the mandatory plan. They would receive more retirement income if they could opt out of the plan and invest their contributions elsewhere. Teachers with shorter tenures end up subsidizing the large pensions received by the longest-tenured teachers. Only 35 percent of new hires and 47 percent of teachers who work at least five years will receive pensions more valuable than their required plan contributions.

Various plan changes could distribute benefits more evenly across the workforce. California could switch to a cash balance plan, which could treat all teachers fairly because school districts and the state could contribute the same share of teachers' salaries to their retirement accounts, regardless of the teacher's age or years of service.

Moving to a 401(k) plan as a replacement to the traditional defined benefit plan or a supplement to it could also help equalize retirement benefits among teachers. In a 401(k)-type plan, all participants could receive the same employer contribution relative to their salaries, regardless of age or years of service. Alternatively, the California State Teachers' Retirement System could distribute benefits more equitably across the workforce by altering the plan's benefit formula.

Requiring public school teachers to contribute to a retirement plan that may not benefit them may not be unconstitutional, but it sure seems unfair.

The Urban Institute

by Richard W. Johnson

April 1, 2016

As an organization, the Urban Institute does not take positions on issues. Scholars are independent and empowered to share their evidence-based views and recommendations shaped by research.

[Florida Launches Bond Program to Finance P3s.](#)

BRADENTON, Fla. – New Florida legislation makes it possible to use tax-exempt financing as part of public-private partnerships for transportation, though P3 backers must convince an influential skeptic.

On Monday, Gov. Rick Scott signed House Bill 7027 into law, creating the nonprofit Florida Department of Transportation Financing Corp.

The corporation, to be overseen by the Division of Bond Finance, will be the state's first conduit issuer for Florida DOT bonds.

The projects most likely to be financed are those using public-private partnerships, agency officials said.

The legislation also requires that FDOT consult with the Division of Bond Finance on P3 financing strategies, and allows the division to "make an independent recommendation" to the governor.

Creating of the new financing mechanism “has been criticized by some in the private sector,” attorneys at Squire Patton Boggs wrote in a March 3 review of the U.S. Public Private Partnership Sector.

“Such bond issuances would require the approval of the State Bond Director...who is viewed by some in the private sector as being unsupportive of P3s,” they wrote.

Until now, however, the Division of Bond Finance has not been consulted on financing proposals for FDOT’s P3 projects, director Ben Watkins said Tuesday.

“I’m viewed as anti-P3 because I will be objective,” Watkins said. “What I care about is financing in the cheapest possible way. You can have the benefit of the private sector on the design and construction, but tax-exempt financing is eminently more cost effective.

“The two are not mutually exclusive, and P3 proponents would have you believe they are,” Watkins said.

To date, Florida’s three mega-P3 projects – all of which won numerous industry awards – have been financed primarily with vendor-organized bank loans, along with equity and low-interest federal loans through the Transportation Infrastructure Finance and Innovation Act.

Those projects are the Interstate 595 express lane project in Fort Lauderdale, the Port of Miami Tunnels, and the I-4 Ultimate project.

FDOT’s first P3, the I-595 project, was also the first in the nation to use an availability payment scheme using a 35-year concession contract negotiated in 2009.

The project opened in 2014, while payments for operations and maintenance run through 2044.

It cost \$1.8 billion to build, but payments over the length of the concession will cost the state \$4.27 billion, according to state documents.

The twin underwater tunnels to the Port of Miami were built to relieve traffic congestion through the city, also negotiated in 2009.

The tunnels cost \$1 billion to build, and opened in 2014.

The contract also has a maintenance component that runs through 2044. It will cost \$2.39 billion.

The most recent mega-P3 is the I-4 Ultimate project in the Orlando area.

Work on the 21-mile project started in late 2014 and is expected to be completed by March 2021.

It is expected to cost \$2.3 billion to build, while the concession’s 40-year price tag will be \$5.04 billion.

“We’ve had to rely on the private sector” for P3 financing, FDOT Secretary Jim Boxold told The Bond Buyer Monday after the governor signed HB7027. “This [bill] gives us the option to do public-sector financing with bonds and presumably obtain lower interest rates.”

Until now, he said FDOT has been limited to certain kinds of projects that it could finance with bonds.

State financing has been reserved for purchasing right of way, building bridges, and constructing

certain tolled projects, including those operated by the Florida Turnpike Enterprise.

FDOT also is also authorized to use grant anticipation revenue vehicle bonds, though Florida has never issued Garvees.

Boxold said the new conduit bond program will allow his agency to advance large and small projects, and deliver them quicker, while ensuring that borrowing costs are kept to a minimum.

“This has the potential to result in significant cost savings on large-scale projects,” he said, adding that bonding may not be used in every instance.

It gives FDOT an opportunity to “run the numbers” and select the most favorable financing method, he added.

According to Watkins, unwinding a portion of the state’s first P3 set the stage for evaluating the use of tax-exempt financing.

In 2009, when FDOT closed on the 13-mile, I-595 project, \$780 million of the \$1.8 billion construction cost was financed with 10-year loans from a dozen banks.

An analysis of the 35-year P3 deal showed that public financing would have been significantly less expensive than the private-sector financing, Watkins said.

The bank loans were refinanced last year using a private placement and taxable bonds.

Watkins said the state potentially could have saved “hundreds of millions” of dollars if tax-exempt bonding had been an option to finance the I-595 deal initially.

“We deconstructed that transaction because it became clear to me that there was a better mouse trap,” he said. “The notion is we can do that more cost effectively rather than leave financing up to the vendor.

“I call this P3 2.0 – the second generation.”

Work on the new bond program also led to a new era of cooperation between FDOT and the Division of Bond Finance, Watkins said.

He credited Boxold and other transportation officials in the secretary’s administration for supporting the evaluation of alternative financing for P3s.

FDOT saw potential for the bond program after evaluating the financial impact of the first P3s on the agency’s work program, Boxold told the House Transportation & Economic Development Appropriations Subcommittee in January.

Paying for private-sector financing over time consumed much of the funds available for other DOT projects, Boxold told the committee.

FDOT’s funding will go further using lower-cost tax-exempt bonds upfront, he said, adding that the new program is “another tool to deliver these projects” without impacting the work program.

THE BOND BUYER

BY SOURCE MEDIA

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