Seattle Adopts an Old Way to Pay for New Parks.

Seattle produces some of the finest brewed coffee in the country, and some of the top software. Even its long mild winters are among the best in the world. But if you ask Seattleites what gives them the greatest civic pride, many will point to their world-class city parks. Seattle's leaders often use parks in the same sentence with words like "community identity," "bridging generations" and "social justice."

That's why it's so encouraging that Seattle voters recently reconceived how they'll pay for them. Like Amazon with online retailing or Costco with big-box stores, Seattle might be out ahead with yet another disruptive trend for its citizens.

Let me start with some basics. "General" and "essential" are synonyms in the traditional lexicon of local public finance. Essential local services like police, fire, libraries and parks are funded with general property and sales taxes. These services are so important that everyone pays, regardless of how much or little they use them. The revenues flow into the city's general fund, where local elected officials decide how to spend them. Essential services are, by definition, high priorities in the general fund budget.

Of course, there are exceptions. In rural areas, for instance, it's often cheaper to spread the costs of fire protection over a wide geographic area. In that case, it's appropriate to levy a special property tax that covers multiple cities. The opposite is also true. Essential infrastructure that mostly benefits a particular group of properties is a good candidate for a special assessment where only the owners of the affected properties pay the tax. In these cases, it makes sense to pay for essential services with special revenues rather than general revenues.

Seattle has turned this logic inside out. In a recent election, voters approved the creation of a new metropolitan parks district. There's nothing special about this district or its services. Its geographic boundaries match the city of Seattle's. The city council will serve as the district's governing body. The only difference — and it's a crucial one — is that the taxes it collects will bypass the general fund and go directly to parks. Cities such as Chicago, Washington, D.C., and even nearby Tacoma have funded parks this way for decades. Seattle voters seem to think this throwback model is the only way to protect this essential service from the political machinations of the general fund.

Some parks advocates have called this a huge win. No more cutting maintenance on parks facilities during recessions. No more choosing between parks and police. New parks that have lived on the drawing board for years can now come to life. Property owners can literally see what they get for part of their property tax dollar. These are all good things.

Other things aren't so positive. When money comes from the general fund, taxpayers can take their concerns directly to the city council. If they don't like the council's answer, they can vote to replace a member. When the money comes from a special levy, like the one that now funds part of Seattle's parks, residents can vote to end that levy. In the special district model, the lines of accountability aren't so clear. Voters' only direct recourse may be to dissolve or restructure the district with a separate future ballot initiative.

The biggest concern is that under this new model, access to stable revenues might be controlled not by policymakers, but by the ability to organize a get-out-the-vote initiative. Some worry this could leave many citizens, especially the poor, out of the mix. So far that's not the case, but critics worry about the possibilities.

It's easy to see why advocates for parks — and other essential services — might want to pursue this model. As general fund resources become harder to find, why not take the case for essential services directly to the voters? If Seattle is a bellwether for things to come, we'll need to fundamentally rethink much of what we know about local public finance.

GOVERNING.COM

BY JUSTIN GERDES | OCTOBER 2014

World Trade Center Tower Rides a Muni-Bond Revival.

Developer to Sell $1.6 Billion of Tax-Exempt Bonds

After more than a year of uncertainty, a third tower at the World Trade Center site appears poised to rise thanks to an unlikely catalyst: a turnaround in the market for municipal bonds.

Developer Larry Silverstein is planning to sell $1.6 billion of tax-exempt bonds to finance 3 World Trade Center as soon as next week, a move that would give the 1,170-foot tall New York tower the funding to move forward.

If the sale proves successful, the 2.5 million square-foot tower would be the latest byproduct of investors' hunt for yield. With Treasury yields pushing lower, investors have been searching for investments that generate better returns, even if the risks are greater, benefiting everything from Silicon Valley startups to toll roads.

Executives involved with the tower began looking for money last year and determined there wasn't enough investor demand. But a rally in the muni-bond market has given them confidence the bonds will sell and the tower can rise on the 16-acre site.

The improvement in the muni market "has created real optimism about this transaction," said Janno Lieber, who oversees World Trade Center development for Silverstein Properties Inc.

Limited muni-bond supply due to reduced borrowing by cities and states helped push muni-bond rates to a 2014 low of 2.19% last week, from 3.3% in January, according to the S&P Municipal Bond Index. Bond yields move in the opposite direction of prices.

The 3 World Trade Center bonds would be at a higher rate—expected to be between 5% and 6%—but still below what traditional lenders charge for construction debt. Adding to their appeal: The tower's bonds are tax-exempt because of congressional action related to the site's rebuilding.

Still, the bonds aren't without risk. The 3 World Trade property, nearly the size of the Empire State Building, is just 20% leased, leaving a large space to be filled in an office market that is only gradually improving.

“Rates are so low that people are stretching for yield, which often means going down the credit scale,” said Howard Cure, head of municipal research at Evercore Wealth Management LLC, which oversees about $5.4 billion.

Silverstein has been planning the tower for years, although construction was halted at eight stories until the developer locked in a tenant and financing, based on the terms of a 2010 government-aid agreement.

The developer secured its tenant last year when advertising firm GroupM, a division of WPP, agreed to take 515,000 square feet in the base of the building.

But when Silverstein looked at its options for financing, it saw that the interest payments on municipal debt would be too high. Meanwhile, banks weren’t willing to make a loan for a building with so much vacancy. Lenders have remained relatively conservative since the downturn, and typically lend only for buildings with significant leasing agreements in place.

“The banks are not in a position to take that risk yet,” Christopher Haynes, president of loan-advisory firm Broadacre Financial Corp., said of construction loans for office towers without tenants. “I just don’t think the market’s there.”

Silverstein initially went to the Port Authority of New York and New Jersey—which owns the 16-acre site—and asked the agency to back most of the debt. While agency officials were supportive, its board rejected the request in the early summer, leading Mr. Silverstein to turn back to the bond market.

The result was encouraging. Silverstein’s bankers at Goldman Sachs Group Inc. and other advisers told the developer the deal might be able to work based on the terms of the 2010 aid package, in which the Port Authority would cover the first $210 million of shortfalls to investors.

Aided further by a noticeable uptick in the lower-Manhattan leasing market, Silverstein put in $50 million of equity and the bankers began to seek investors.

In recent weeks, bond managers have toured the site, walking through the under-construction concourse below the tower while strolling by 4 World Trade Center, the recently completed tower that also was built by Silverstein, and 7 World Trade Center, Silverstein’s fully leased tower built in 2006.

For the investors, the risk lies largely with the state of the Manhattan office market. While a number of companies like Time Inc. recently have been opting to move from Midtown to lower Manhattan, any slowdown in the economy could quickly put a halt to pricey moves and cause companies to stay in place.

It isn’t clear how much time Silverstein believes the building will take to lease up fully. But an independent appraisal provided to bond investors projects the tower will be leased by 2021, three years after it is completed, assuming it secures financing this fall.

THE WALL STREET JOURNAL

By ELIOT BROWN And AARON KURILOFF

Oct. 21, 2014 7:17 p.m. ET

—Andrew Tangel contributed to this article.

Write to Eliot Brown at eliot.brown@wsj.com and Aaron Kuriloff at Aaron.Kuriloff@wsj.com

---

BlackRock Sales in October Rally Signal Its Limits.

The municipal-bond market's rally this year has confounded Wall Street expectations, culminating in the best October performance since 2001 and drawing the most cash in two years. BlackRock Inc. (BLK) has had enough.

After an unprecedented nine straight months of muni gains, the world's biggest money manager said it sold some of the debt as benchmark yields sank to a 16-month low. Vanguard Group Inc. also says the market is vulnerable to losses at current levels.

Munis have earned 1.2 percent this month, on pace for the biggest October gain since a 1.4 percent return in 2001, according to Bank of America Merrill Lynch data. While municipal issuers may welcome diving borrowing costs, investors are growing wary of buying as yields approach generational lows.

"We've taken a little bit off the table in the last few days," Peter Hayes, who oversees $122 billion as head of munis at New York-based BlackRock, said in an Oct. 16 interview. "Nobody really expects rates to rally significantly from here. In fact, I think everybody is waiting for a little bit of a pullback. That's what we'll wait for."

Outlier Rally

Benchmark 10-year muni yields have increased 0.03 percentage point since touching 1.94 percent on Oct. 16, the lowest level since May 2013, Bloomberg data show. They started 2014 at 3 percent.

This year's return for munis has defied forecasts of analysts and investors in the $3.7 trillion market. Morgan Stanley's main scenario for 2014 was for losses of at least 1.7 percent, while Barclays Plc estimated a 1.45 percent drop. In April, Citigroup Inc. joined the chorus of those advocating sales.

Instead, munis have rallied in each of the first nine months of 2014, a feat that hasn't been seen in the past 25 years, according to Bank of America data.

States and cities across the U.S. are taking advantage of lower rates to finance projects or refund higher-cost debt.

New York won the lowest borrowing costs in at least half a century last week when it issued 30-year sales-tax bonds at a yield of 2.87 percent, according to the state budget office. It added $150 million of debt to the deal because of the reduced rates.

Carolina 'Jackpot'

South Carolina's public-service authority, known as Santee Cooper, borrowed an extra $186 million amid the falling interest rates, said Chief Financial Officer Jeff Armfield.

In Florida, Miami-Dade County Public Schools "hit the jackpot," said Treasurer Leo Fernandez. The district's refinancing will save almost $24 million, compared with the projected $14 million, he said in a telephone interview.

Municipalities across the country have scheduled about $10.5 billion of sales during the next 30 days, the most in four weeks, Bloomberg data show. State and cities have issued $219 billion of fixed-rate, long-term debt this year, 8 percent below last year's pace, helping stoke the rally.

"Munis are fully valued, overbought and potentially exposed to a backup, particularly if we get heavy supply over the remainder of the year," said Chris Alwine, who oversees $140 billion of state and local debt as head of munis at Vanguard in Valley Forge, Pennsylvania.

2012 Echo

While Vanguard isn't selling bonds to raise cash, it's looking for debt that will retain value better in declines, Alwine said. He said current yield levels echo the end of 2012, when interest rates fell to the lowest since the 1960s before rising amid the worst yearly losses since 2008.

Morgan Stanley, which predicted 2013's decline, is again projecting losses. The bank's main scenario is for the market to lose 0.88 percent in the next 12 months, Michael Zezas, its chief municipal strategist, wrote in an Oct. 6 report.

The consensus on Wall Street is for yields to rise as the economy strengthens. Ten-year Treasury yields will reach about 3.2 percent in the third quarter of 2015, about a percentage point above current levels, according to the median forecast of 76 analysts in a Bloomberg survey.

Tim McGregor at Northern Trust and Jamie Pagliocco, director of bond managers in Merrimack, New Hampshire, at Fidelity Investments, aren't so quick to call an end to the rally as individuals have added to muni mutual funds for 14 straight weeks. It's the longest stretch since October 2012, Lipper US Fund Flows data show.

Cash Influx

The influx may absorb new deals for the remainder of the year and keep yields near current levels, the asset managers say.

"We've got four to five solid weeks of supply ahead, but it seems like there's cash to make it through that without too much adjustment," said McGregor, who oversees $30 billion as head of munis at Northern Trust in Chicago. "I would still count on a lot of volatility along the way."

Relative value may stand in the way of a sustained muni rally: The debt has outperformed some major fixed-income counterparts this year. While state and city bonds have gained 9.7 percent, Treasuries have earned 5.5 percent and investment-grade company securities have returned 7.6 percent, Bank of America data show.

As a result, the ratio of 10-year muni yields to similar-maturity Treasuries has dropped to 90 percent, compared with a five-year average of 98 percent, Bloomberg data show. The lower the figure, the costlier state and local debt is in comparison with federal obligations.

For BlackRock, which said in an outlook in December that munis entered 2014 "reasonably valued," that's no longer the case.

"I'm not sure the municipal market is priced right," Hayes said. "You can use strength like we've seen to sell into it, put cash on the sidelines and wait for better opportunities down the road."

Bloomberg

By Brian Chappatta

Oct 20, 2014 7:06 AM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum

---

Pimco Sees Returns Ebbing After Best Gain Since '11: Muni Credit.

With the $3.7 trillion municipal market poised for its biggest annual gain since 2011, this year is going to be a tough act to beat, say Pacific Investment Management Co. and Morgan Stanley.

Returns in 2015 may be less than half of the 8.7 percent logged in 2014 as interest rates have probably bottomed out close to generational lows, according to Pimco, the $2 trillion fixed-income manager, and Morgan Stanley, owner of the world's largest brokerage.

Gains are probably set to diminish as the Federal Reserve wraps up its bond-buying program and prepares to raise interest rates, said Michael Zezas, chief municipal strategist at Morgan Stanley in New York. The prospect of skimpier earnings for investors has significance for municipalities as well: Demand from buyers chasing this year's rally has helped push borrowing costs toward generational lows for officials financing schools, roads and water systems.

"You've already run it fairly far," said Joe Deane, New York-based head of munis for Pimco, whose co-founder Bill Gross departed on Sept. 26. "From these levels, to have this kind of a return, you would have to take interest rates down to some dramatic levels. I don't see that being in the cards."

2015 Call

State and local debt will earn about 3 percent in 2015, said Deane, whose company manages $50 billion of munis.

While that would still mark a second straight year of gains, it may temper the appetite of individual investors, who have poured cash into U.S. muni mutual funds for 13 straight weeks. That's the longest stretch since 2012, according to Lipper US Fund Flows data.

The demand pushed yields on benchmark 10-year munis to 2.05 percent, the lowest since May 2013, after the interest rate fell for three straight quarters. Yields may reverse course in 2015 if investors pull back from local obligations in anticipation that the Fed will raise its benchmark lending rate, Zezas said.

The central bank will lift its target, which has been near zero since 2008, starting in the third quarter of 2015, according to the median forecast of 82 analysts surveyed by Bloomberg. Morgan Stanley expects the Fed boosts to start in the first quarter of 2016.

Base Case

"We expect rates to gradually move higher and volatility to pick up as we get closer to a Fed exit," Zezas said. "Those are things that are a risk in muni performance."

Morgan Stanley's main scenario is for munis to lose 0.88 percent in the next 12 months, Zezas wrote in an Oct. 6 report.

"We more or less expect flat returns as a base case," Zezas said by phone. "But the skew of potential return outcomes is certainly meaningfully lower than what we've experienced over the last 12 months."

Yields on 10-year Treasuries will reach 3.25 percent in the third quarter of 2015, about a percentage point above current levels, according to the median forecast of 75 analysts in a Bloomberg survey.

State and city debt has defied Zezas's year-end 2013 forecast. At the time, he laid out a base-case scenario for this year in which munis would lose at least 1.7 percent.

Rebound Year

The return this year follows a loss of 2.6 percent in 2013, S&P Dow Jones Indices show. The assets are on track for their best performance since 2011, when they gained 10.6 percent.

Daniel Ivascyn succeeded Gross as Pimco's chief investment officer. Gross helped its Total Return Fund (PTTRX) become the world's biggest bond mutual fund, with about $202 billion of assets, of which 4.2 percent was in munis as of June 30.

After the shakeup, shifts in muni allocations will come from market developments and not Gross's departure, Deane said.

"They look to all of these specialist desks — do you like your market, do you not like your market? What's valuable and what's really rich?," Deane said. "I don't think that is going to change."

Deane and Zezas also have a similar view on where investors should look in terms of credit quality, focusing on higher-rated assets instead of the riskier obligations that have outperformed this year as benchmark yields dove.

Munis in the bottom three levels of investment grade have earned 12.9 percent this year, compared with 6.1 percent for top-rated debt, Barclays Plc data show.

Investors should take the opportunity now to trade out of munis rated one to four steps above junk and purchase higher-grade debt, Zezas said.

Pimco focuses on munis in the single-A range, or four to six steps below top-rated securities, and bonds maturing in seven to 20 years, Deane said.

"With the rally that we've had, it just makes us a little more conservative," Deane said. "If we're going to put money to work, it's going to be higher-grade stuff and it's going to be shorter."

Bloomberg

By Michelle Kaske Oct 14, 2014 8:31 AM PT

10/15/2014

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, William Selway

[S&P U.S. State and Local Government Credit Conditions Forecast: Economic Growth is Tinged by Questions of Sustainability.]

U.S. regions have been growing during the past year at a faster pace than we expected. The U.S. Commerce Department's Bureau of Economic Analysis' revised estimate of second-quarter real GDP growth of 4.6% surpassed our expectation of a 4.2% annualized growth rate for the quarter. More generally, the updated official growth estimate confirmed our view that the U.S. economy is gaining momentum. Even before the GDP revision, we had modestly raised our forecast of 2014 real GDP growth to 2.2% from 2.1%. Shortly thereafter, a strong September jobs report followed; thus, several recent indicators offer accumulating evidence that the economy could outperform even our somewhat improved outlook. Welcome as they are, however, indications of faster-paced economic growth create something of a dilemma for state and local government budget officials. Almost across the board, governments have restrained their staffing levels, programmatic funding, and infrastructure investment.

[Striking the Right Note on Public-Private Partnerships.]

Despite some discord, properly managed public-private partnerships can find harmony

Public-private partnerships (PPPs or P3s) have been getting a bad rap lately, causing municipal governments to wonder whether such partnerships really serve public interest — especially as fiscal resources are rebounding following the recession. In a four-part series on PPPs, the Pittsburgh Post-Gazette recently highlighted the pitfalls of making poorly structured financing deals with the private sector to fund infrastructure projects.

Meanwhile, Chicago has been crucified by the public and press for using a P3 to manage 36,000 city parking meters. The private investor, Morgan Stanley Infrastructure Partners, generated $43.6 million in profit by raising parking rates. Morgan Stanley also billed Chicago for $61 million for reimbursement, claiming that, when the city closed streets for construction or street festivals, created bike and bus lanes to reduce traffic or allowed someone else to build a competing parking garage, Morgan Stanley lost revenue.

Despite the criticism, interest in P3s is growing. Proponents say partnerships are worth exploring because they often result in creative solutions to delivering and funding public services and infrastructure projects.

"It's safe to say governments at all levels are faced with budget constraints and there is inherent budget scrutiny," says Todd Herberghs, executive director for the National Council for Public-Private Partnerships (NCPPP). "As officials are reluctant to increase revenues through taxes, but government still has to deliver the same services, P3s are a great avenue to explore for funding."

Nationwide, more communities are implementing legislation to facilitate and expand the use of PPPs to improve service and control costs through competition and reduced overhead, says Richard Norment, an independent consultant for PPPs and NCPPP senior fellow. "The number of states that have passed new partnership transportation legislation has plateaued at 34, but what has expanded rapidly is legislation for social infrastructure — water systems, schools, libraries, parking lots. [Such legislation] has eclipsed the transportation number, with 49 states having statutes for such projects," he says.

Given the facts, “We encourage P3s as an option for local governments, but we don’t encourage rushing into them to get something paid for. That can lead to bad deals,” Herberghs cautions. Instead, he suggests communities take time to examine what they are trying to accomplish, do a complete value analysis and determine the true lifecycle costs. “It’s not just free money,” he says.

Broad communication is key to the success of a PPP, Herberghs adds. “Some projects may have felt rushed through or face public opposition because the process was not as open as the public would have hoped,” he says. “It’s important to be as methodical and transparent as possible.”

Colorado recently took steps in this direction, by amending its legislation so that PPPs are more open to public comment.

“I would argue that the ‘soft elements’ in a partnership are at least as important as the financial aspects,” says David Swindell, associate professor of public affairs and director of the Center for Urban Innovation at Arizona State University (ASU). He notes the importance of two-way communication in the relationship. “It’s not just a cost-benefit in terms of dollar and cents. It also includes efficiencies, effectiveness, whether citizens are satisfied, whether city council politics are going to impact the project, etc.” If politics or poor communication is going to hinder a partnership, then a city council should be gun-shy about entering into these types of partnerships, he says.

Susan Mays, vice president of marketing and strategic initiatives for CH2M Hill’s Operations Management Services group, characterizes successful PPPs as partnerships that provide “collaborative service delivery,” rather than involve a community “contracting out a service.” She notes the importance of creating partnership agreements that allow for flexibility, should issues arise that aren’t specifically spelled out in the contract. She says one agreement her company has with a city says nothing about being a good corporate citizen, but her staff knows the mayor expects the company to participate and be part of the community. “When you look at signing a contract for 10, 20, 30 years, what’s in the contract isn’t going to make the project successful. It’s the skills on both sides of the table that build on a collaborative arrangement.”

“‘Contracting out’ frequently involves a community contract out service X for given price at X quantity. That’s nothing more than city paying a vendor for a service — a contractual relationship. I don’t consider that sort of privatization a partnership,” Swindell says. “A partnership is when both parties are involved — collaborative service delivery” — and both parties benefit.

To help communities determine whether their projects are ripe for partnership with the private sector, ASU has developed a tool to evaluate the chance of success. “We’ve been working on a tool to help communities decide whether they should be doing it in first place. Given the service and given the context of the community, is collaborating the right thing, or should the project remain in-house?” Swindell says.

The success of a P3 hinges on more than just the financial viability of the project and partner. Some services are more amenable to collaboration with public or private sector delivery. Is the leadership stable or is there a lot of turnover? “Would you want to have a partner that can’t keep its leadership in place and might change its mind on the value of partnership? One of the characteristics of success is leadership stability and talent of the partners — do they have a track record of being competent in these types of partnerships?” he asks.

In the ’90s and early 2000s, there was a push for PPPs, then states, cities and counties moved away from these arrangements because public entities didn’t feel like they were getting what they wanted out of the partnership, and often they weren’t really designed as a partnership, Swindell says. A successful partnership clearly spells out the goals, what each partner’s responsibilities are, and the benefits.

“The private sector needs to profit, and the public sector needs the service. How you specify the agreement and note what each party is contributing to the process and derives from the process isn’t always equal in dollars… We’re now seeing private-sector companies that better understand what the public needs to get out of this and a lot more sophisticated city managers that are savvy to what they need to specify in arrangements so the relationships all work the way parties want them to work,” he says.

John Danielson, city manager for Centennial, Colo., likens a PPP to a marriage. “If both folks want to work on the relationship, it will work to the best of circumstances,” he says. His city of approximately 100,000 residents works with the private sector to provide service delivery for all of its public works, from snow plowing to surveying. This has allowed the city to operate with only 50 employees, while benefitting from the expertise of private professionals. “I get the benefits of super, high-quality work for only the time that I need it,” he says.

However, he recognizes that his city’s P3s are successful because his staff doesn’t operate with a superior-subordinate relationship. He says his staff checks in with major partners every Monday, not to go over every aspect of the contract, but to monitor progress, whether they have the right people and equipment in place, and whether they’ve communicated everything to the public about what they will be doing to meet expectations. “It’s similar to in-house staff meetings, and difficult to tell the difference between city employees and private contractors when they’re physically together in the same room,” he says.

“The group works as a team, keeping in mind the basis of the contract is I win, you win,” Danielson adds. “There has to be a reason for us to be together and for this to work out. I get goods and services on a level that meets my and the residents’ needs. You’re on the other side of it and provide a service and generate a profit, keep people working and keep shareholders happy.”

When the public and private sector works in sync, it can yield innovative and impressive results, Mays says. “Financing is really one of the triggers [for P3s,]” she says. “However, communities also can benefit from P3s in other ways. Perhaps the private sector has technical expertise or the technology to do something more efficiently or effectively. Or, perhaps it’s better to partner with the private sector to help transfer some of the risk.”

The community of Sandy Springs, Ga., is so sold on the benefits of PPPs that Mayor Rusty Paul says he’s “double-downed” on them after outsourcing all city services except police, fire and 911.

In 2005, the city of nearly 90,000 residents signed a comprehensive PPP contract for all major city functions, including administrative services and nearly all public works functions. Today, Paul says he rebids the contracts every three years to make sure contractors are fulfilling their obligations on service delivery, and he has a backup contractor lined up in case the primary contractor fails to meet expectations.

Paul says his city’s commitment to the privatization model has improved customer satisfaction and helped contractors feel like they are part of the fabric of the community. “Private sector partners know their number one job is to focus on service to earn a paycheck,” Paul says. “We foster a teamwork environment and our private sector partners play an essential role and are partners in delivery services to the public.”

The bonus, he says, is that by contracting out services to the private sector, his city has price predictability in providing services for several years, which frees up the budget to provide additional city services. Because of PPPs, 25 percent of the city's budget can now be used for capital projects and improvements like repairing streets and creating new parks and public art.

Another example involves Fairfax County, Va., which is building its Metro line. David Birtwistle, CEO of the Virginia Transportation Alliance, said at the end of the first phase of the Metro line expansion in Reston, Va., the county needed a parking facility to accommodate ridership. Knowing that such a project would be expensive, it sought a private partner to provide the parking structure.

When it solicited bids, Fairfax received a bid from Comstock Partners that wanted to charge double what it would be to build 2,300 parking spaces. The bid seemed strange at first, consultant Norment says, but it turns out the developer proposed the project with an additional 3,000 parking spots for no charge so that it could put a mixed-use residential/commercial facility on top of the parking spaces and pay the county for the air rights of the structure. In addition to the parking spaces, the project now includes a commuter park-and-ride facility, transit bus depot, 1.3 million square-foot, mixed-use center that will include 900 luxury apartments, a 200-plus-room hotel, restaurants and office and retail space.

"It created very positive cash flow for the county," Norment says, noting more innovative projects like these are cropping up, with more wrinkles than in years past. "The adage goes, 'if you've seen one PPP, you've seen one PPP.'"

P3s may not be the best solution for governments that are reluctant to raise taxes to fund infrastructure projects, but they are worth considering, Sandy Springs' Paul and Centennial's Danielson say.

"You don't have to roil the whole city and throw out every department to private sector [management] at once," Paul says. Yet, if you give PPPs a chance, "you may be pleasantly surprised by the enthusiasm and innovation you get out of the process."

Danielson suggests communities start with areas that are the least or most poorly served — areas in which you struggle to operate. "If things are not going well, it might be a great place to start looking at a partnership to see if there is a different service model that doesn't cost you any more money. Find someone who has a good partnership and spend a few days to find out what works and doesn't, and what things that might fit in your organization," he says.

Even if resources aren't as tight as they used to be, "when state and local governments look for ways to meet public need, P3s very much belong as part of the evaluation process," Birtwistle says. "The pitfall is that [P3s] were looked at as financing mechanisms, and as revenues increase, [there] may be less of a reliance or interest in such partnerships.

However, partnerships can bring more than just financial resources to the table. They can bring new ideas and more efficient solutions that the public sector may not otherwise have had opportunities to. It would be unfortunate if the public sector didn't continue to look at P3s as an option to a project. It's not the solution in all cases — but in many cases it can be advantageous," Birtwistle says.

By Patricia-Anne Tom | American City and County

Sept. 24, 2014

Virginia to Debate New P3 Guidelines for Roads.

Virginia's transportation board and other officials could face new responsibility to conduct risk assessment and communicate their findings to legislators and the public for P3s. That is a recommendation included in draft guidelines released by state transportation officials Oct. 14.

The state solicited new guidelines following concerns over the U.S. 460 project pursued by former Virginia Gov. Bob McDonald (R). Current Gov. Terry McAuliffe (D) suspended work on the highway in March after learning the project had spent close to $500 million without a groundbreaking. An inspector general's review found the commonwealth's hasty pursuit of the project allowed it to move forward with little oversight.

Under the guidelines, a new decision matrix would require the Commonwealth Transportation Board to review and approve action before:

- a project enters the development stages and the commonwealth begins to spend money;
- the procurement process begins; and
- a final contract is signed.

"With guidelines like this in place, we would have never gotten to the point we did and spend the money we did on the Route 460 P3 project," Aubrey Layne Jr., Virginia's Secretary of Transportation, told the Richmond Times-Dispatch.

The proposal would expand Virginia's P3 steering committee to include members of the transportation board, chairmen of the House and Senate transportation committees, and an independent financial expert from within the government.

Meetings of the steering committee would require 30 days' notice, briefings for relevant committees at the state legislature, and increased public engagement.

"We fully understand the need for more accountability and transparency in the process," Layne said, "and we believe it should be a more competitive process, too."

For projects over $100 million or those with complex environmental approval processes, the commonwealth would be required to develop risk-mitigation plans, and the risks would be disclosed to lawmakers before procurement started.

S&P's Public Finance Podcast (State Debt and the Rating Action on Pennsylvania).

On this week's segment of Extra Credit, Standard & Poor's Director Henry Henderson discusses our commentary on state debt and Senior Director John Sugden explains our rating action on Pennsylvania.

Listen to the podcast.

Oct 17, 2014

MMA Municipal Issuer Brief - October 20, 2014.

The Municipal Market Advisors warned this week that investors looking at local governments with any hint of distress had better take a hard look at pension debt load. Developments in the bankruptcies of Stockton, Calif., and Detroit have "jeopardized the repayment of capital market creditors," MMA said, and ultimately pensioners are making out better than bondholders when a city is forced to restructure its debts. The firm advised that local governments' investment worthiness be viewed "holistically," meaning that "the costs associated with repaying public debt plus pensions plus OPEBs (retiree healthcare) plus direct loans and other important contractual relationships should be considered when modeling payment capacity."

Read the Brief.

Munis Poised for Biggest October Gain Since 2000 Amid Bond Rally.

The $3.7 trillion municipal market is poised for its biggest October rally in 14 years, pushing yields to 16-month lows in defiance of historical trading patterns for the month.

State and local debt has earned 1.45 percent this month, on pace for the best October performance since a 1.5 percent gain in 2000, according to Bank of America Merrill Lynch data. Yields on benchmark 10-year munis have dropped 0.28 percentage point this month, the most since January, to 1.95 percent, data compiled by Bloomberg show.

The move contrasts with the past five years. Yields have jumped an average of 0.19 percentage point in October since 2009, more than all periods except June. The municipal market has joined a volatile October for financial markets: Stocks worldwide lost about $3.3 trillion in market value during the month through yesterday and 10-year Treasury yields dipped below 2 percent for the first time since June 2013.

"The market is going against investors' expectations of higher rates — we've gone nothing but down," said Peter Hayes, head of munis at New York-based BlackRock Inc. (BLK), which oversees $122 billion in local debt. "Rates are certainly getting close to their all-time lows again."

For state and local bonds, the gains extend a streak in 2014 of no monthly losses, an unprecedented feat over the past 25 years. Fueling the advance, individuals have added to muni mutual funds for 14 straight weeks, the longest stretch since October 2012, Lipper US Fund Flows data show.

Munis' 9.9 percent return this year compares with 5.7 percent for Treasuries, Bank of America data show. That's pushed the ratio of 10-year muni yields to similar-maturity Treasuries to 88 percent, close to the lowest this year, Bloomberg data show. A lower figure signals state and local debt is growing costlier relative to federal debt.

BLOOMBERG

By Brian Chappatta Oct 17, 2014 8:07 AM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net

Mark Tannenbaum, Alan Goldstein

Moody's: Advantages of Century Bonds to Finance Infrastructure Come at a Cost.

New York, October 08, 2014 — Bonds with very long maturities of up to a 100 years—century bonds—can have an appeal for infrastructure bond issuers, says Moody's Investors Service, because they are able to match the long-term service lives of the assets they are financing to the long-term maturities of the debt, deferring rate increases and capital cost recovery for generations. However, these advantages carry some credit risks.

"The issuance of ultra long-dated debt such as century bonds by infrastructure issuers defers rate increases or cost reductions in the near- to medium-term, which runs counter to a key credit strength of infrastructure enterprises: the ability and willingness to raise rates to recover costs of operating and investing in the system," says Moody's Vice President Nick Samuels in the new report, "Century Bonds Create Opportunities and Challenges for US Public Infrastructure Issuers."

Century bonds have become a topic of discussion among infrastructure debt issuers and investors after District of Columbia Water and Sewer Authority (DC Water) sold a $350 million century bond this summer to help finance a part of a $2.6 billion consent decree mandated Clean Rivers Project.

From an operating perspective, a century bond issuer gains flexibility by deferring debt service costs far into the future. However, adding century bonds to a debt portfolio can lessen long-term financial flexibility and raise long-run costs.

Compared to a traditional 30-35 year amortization for an infrastructure issuer, a 100-year structure more than triples the total debt service costs.

The water tunnels DC Water was financing are designed to have a useful life of at least 100 years. The authority sought to capitalize on this span and reduce its near-term financing costs by issuing the century bonds, which pay interest only for 90 years and then sinking fund deposits in the final 10 years. Ample investor demand allowed DC Water to both increase the deal's size from the planned $300 million and reduce the bonds' yield from its original assumptions.

This had been the first century bond deal in infrastructure since Port Authority of New York and New Jersey in 1994.

Recently, the Cleveland Clinic Health System issued a $400 million century bond, a first in the not-for-profit healthcare sector. Several higher education institutions with strong national reputations have also issued century bonds, and they have also been issued by several corporate issuers.

For more information, Moody's research subscribers can access the report at

http://www.moodys.com/viewresearchdoc.aspx?docid=PBM_PBM176188.

State Economic Monitor: October 2014.

Most states ended the summer of 2014 on a positive economic note. Up from 14 states a year earlier, 25 states reported August unemployment rates below 6 percent. Every state but Alaska added jobs within the last year. But some troubling signs remain. Inflation-adjusted average weekly wages declined or did not change in 26 states. The latest issue of the State Economic Monitor describes economic and fiscal trends at the state level, highlighting particular differences across the states in employment, state government finances, and housing conditions. This issue also includes a special section on state minimum wages.

Read the complete document.

Richard C. Auxier
October 16, 2014

Squeeze on US Muni Sales Boosts Prices.

US states and cities have cut borrowing by 6 per cent so far this year as they rein in spending and tap other sources of funding for infrastructure projects and the maintenance of public services.

New issuance of "muni" bonds has been slowing in the past couple of years in the aftermath of the financial crisis, which ripped holes in municipal budgets.

In addition to fiscal austerity, a growing number of states and city governments in the US have been turning to partnerships with private entities – known as P3s – or tapping into direct credit lines with banks to meet their funding needs, analysts said.

"States and municipalities are generally doing a better job controlling their spending, and are not willing to embark on large projects while the economic outlook is still a bit uncertain," said Rob Taylor, head of municipal finance at Barclays.

"That, combined with the fact that there's been other sources of funding, such as direct bank lending, points to a drop in new issuance in 2014."

Sales of muni debt fell to $202.3bn through the end of September, down from $215.1bn in the same period of 2013, according to data from Thomson Reuters MMD.

Most of the sales' proceeds, or $57.2bn, was earmarked for general purposes, with funding related to education close behind, at $56.6bn. The state of California was the largest issuer of general obligation bonds, at $4.8bn, followed by the commonwealth of Puerto Rico, with $3.5bn.

For investors, the drop in supply has helped boost muni bond prices, which in turn has increased the total return on the securities.

Muni bonds have been one of the best performing assets so far this year, with average total returns on the debt at 8.1 per cent, according to Barclays indices. That compares with a total return of 4 per cent for US Treasuries and 7 per cent for investment grade corporate debt.

"There's no question about how the imbalance between the supply of new issues and demand has created a very favourable landscape for positive returns," said Jim Colby, chief municipal strategist at Van Eck Global.

"It's a compelling backdrop for many investors, specially when you also factor in some of the tax incentives attached to the securities."

As an incentive to invest in public projects and to keep borrowing costs low, interest income from munis is exempt from federal taxes. Many munis can also be exempt from state taxes and from local taxes too.

The allure of generous tax breaks is clear. An investor in a 35 per cent tax bracket would have to find a fully taxable security, such as a corporate bond, that yields more than 8 per cent to earn the same amount of income.

The strong performance in munis also comes after the worst year for the $4tn market in almost two decades and just one year after Detroit filed the biggest municipal bankruptcy case in US history.

The Financial Times

By Vivianne Rodrigues in New York

October 10, 2014

Monoline Insurers 'Could Reach 10%' of Muni Market Again – Citi.

Like bison on the Great Plains, monoline insurers used to roam in great numbers across the muni-bond landscape. Then the financial crisis hit and monolines nearly went extinct. But now they're on the rebound, and though far less abundant than they were a decade ago, they soon could climb back to relevance in the muni market.

Or not. Citi today says that monolines' share of wrapped new muni bonds "could reach 10% in the future" but acknowledges that "the vast majority of investors continue to largely ignore monoline wraps."

At their peak, monolines – financial institutions with pools of capital and triple-A credit ratings – would insure, or "wrap," bonds by lending their credit ratings (for a fee) to any lower-rated municipality looking to issue bonds. The monolines earned their fees, the issuers achieved lower borrowing costs, and investors could sleep better knowing their bonds were insured, without conducting in-depth credit research of every little municipality out there. At their peak, monolines insured over half the muni market, before most died out after insuring mortgage bonds that defaulted during the financial crisis. From Citi:

"Nowadays monoline insurers play a smaller role, but their market penetration has been growing over the last several years, helped by higher market volatility, as well as, several high profile credit events, and by the growing realization that a handful of insurers provided a solid credit backing for many new issuers. Consequently, monoline share of new issue supply increased from a low level of 4% in 2012 to 6% in 2014 year-to-date, and, in our view, could reach 8-10% over the next several years."

Currently, there are three active monolines: Assured (AGM and MAC) – the most active insurer; BAM – was created just several years ago, but already became a formidable competitor to Assured; and National (was carved out of MBIA), which has started wrapping new deals in 2014.

Citi points out that S&P recently upgraded Assured and National closer to triple-A, while monoline credit spreads have tightened, mirroring their credit quality improvement. Citi says the vast majority of investors continue to underestimate or undervalue the extent of its credit improvement, calling it a “mistake” for investors to ignoring monoline wraps when buying municipal bonds. Citi also sees a difference in value between the two main monolines today:

“With National getting into business again, an interesting question is whether there should be a substantial difference between bonds wrapped by Assured and National. Prior to 2014 this spread differential was as high as 100bp for sone stressed credits; currently, it is on the order of only 25-50 bps for the majority of low-rated names, Given that both insurers are moving in the positive direction, have somewhat similar claims-paying resources and Caribbean exposures, in our view, this differential should be tighter. Assured’s wraps are more valuable, in our view, but this differential for similar credits and maturities may be worth as little as 10-15 bp.”

October 6, 2014, 5:34 P.M. ET
By Michael Aneiro

S&P's Public Finance Podcast (Stockton's Bankruptcy Case And Our Local Government General Obligation Criteria).

In this week’s Extra Credit segment, Standard & Poor’s Director Chris Morgan discusses the recent ruling in the Stockton bankruptcy case regarding the city’s pension contributions, and Director Lisa Schroeer explains the impact of our updated local government general obligation criteria one year after its application.

Listen to the Podcast.

9 October 2014

S&P: U.S. Not-For-Profit Senior-Living Sector Remains Stable Despite Mixed Financial Results.

Median ratios for the U.S. not-for-profit senior-living sector were mixed in 2013, with weaker operating and excess margins offset by balance sheet improvements, particularly liquidity.

We expect the trend of weaker margins to wane over the next several years, as providers continue to leverage improvements in the U.S. economy and housing sector and focus on achieving stronger revenue growth. However, Standard & Poor’s believes meaningful revenue growth will be difficult without occupancy levels in excess of 90%. While occupancy levels have certainly improved from the post-recession lows, they have hovered in the mid to upper 80% range, though the latest data suggests some facilities approaching 90% or higher. The sector’s other challenges include general expense pressures; changes in consumer preferences and care delivery models (for example home health services; remote monitoring or assisted living green house model); and the need for capital investment to reposition dated communities or provide the necessary services and amenities to attract today’s senior population.

We noted last year that it might be difficult for senior-living providers to find the next level of savings to improve operating results. This concern was validated as the operations for providers continued to decline. While the overall median revenue was up in fiscal 2013, the growth rate did not keep pace with the increase in expenses, causing a further decline in the overall median operating margin. We believe expense pressures will persist, as some of the drivers revolve around finding ways to improve occupancy, such as increased sales and marketing expenses. While many organizations experienced some degree of success with their more extensive marketing initiatives, these actions have come at a cost and weakened, in our view, some organizations' operating performance, though we understand these are often short-term solutions to shore up occupancy.

On the positive side, liquidity metrics for most organizations offset these operating pressures, with strong year over year gains, enabling the sector to remain stable. Standard & Poor's believes that, despite some near-term operating pressure, the senior-living sector demonstrates general credit stability, evidenced by the vast majority of sector ratings being affirmed. While we anticipate that there will be continued pockets of operating stress through 2015 and possibly beyond, demand should become more robust as the U.S. economic outlook improves (including the housing sector), baby boomers age, and providers introduce new care delivery models and technologies that can provide higher quality care and reduce cost. Furthermore, many of our rated senior-living providers have experienced management teams and are located in markets with strong demand and limited direct competition.

Continue Reading.

06-Oct-2014

GASB Summary of Technical Plan for the Final Third of 2014.

This high-level summary of the GASB's technical plan for the final third of 2014 includes information on the projects on Asset Retirement Obligations and Blending Requirements for Certain Business-Type Activities that the Board voted to add to the Current Technical Agenda. Information also is included on the pre-agenda research initiated on 2a-7-like External Investment Pools.

GASB Board Meeting Highlights.

The GASB held public meetings August 20–22 and September 8 (by teleconference), 2014, to discuss issues associated with its projects on Leases, Fiduciary Responsibilities, Tax Abatement Disclosures, and Irrevocable Charitable Trusts. The Board also reviewed and approved the Technical Plan for the final third of 2014. (See the accompanying article on the Technical Plan.) This article addresses key tentative decisions made by the Board during its deliberations on these topics. (For complete minutes of the Board meeting, visit the project pages devoted to each project on the GASB website.)

Leases

The Board's deliberations in August on potential revisions to the standards on lease accounting included recognition and disclosure issues related to lease terminations, lease modifications, and multiple lease components. The September deliberations considered sale-leaseback transactions and included a review of draft chapters of a Preliminary Views.

Lease Terminations

The Board began deliberations by discussing additional potential disclosures. The Board tentatively decided to propose that a lessor government should disclose the existence, and terms and conditions, of options by the lessee to terminate a lease if the lessor government has issued debt for which the principal and interest payments are secured by the lease payments. The Board tentatively decided to propose that for the termination of a lease (other than a transaction associated with the lessee's purchase of the underlying asset), the lessee would remove the lease asset and obligation from its financial statements, and recognize the difference as a gain or loss. The Board also tentatively decided to propose that for a lease termination that is associated with the lessee's purchase of the underlying asset, the lessee would record the difference between the purchase price and carrying amount of the lease liability as an adjustment to the carrying amount of the underlying asset. The Board tentatively decided to propose that for a lease termination, the lessor would remove the lease receivable and related deferred inflow of resources, and recognize any difference as a gain or loss.

Lease Modifications

The Board considered how to account for and report modifications to leases relating to several potential changes in a lease's terms and conditions. The initial measurement of the assets, liabilities, and deferred inflows of resources related to a lease is based on the specific features of the lease. If those features change during the period of the lease, the measurements need to be adjusted accordingly.

The Board tentatively decided to propose a general approach to be used for lease modifications: A change in the lease contract would be considered a modification of the original lease if the lessee keeps the same right of use. On the other hand, a change would be considered a new lease (and the original lease terminated) if the lessee loses part of its right of use.

<u>Changes in Consideration.</u> The Board tentatively decided to propose that for a lease modification resulting from a change in consideration, the lessee would remeasure the lease liability on the effective date of modification and assess the need for an updated discount rate. The lessee also would adjust the right-of-use asset (the intangible asset it would recognize, related to its right to use the asset being leased) by the difference between the modified liability and the liability immediately before the modification, recognizing neither a gain nor loss. For the lessor, the Board tentatively decided to propose that it remeasure the lease receivable on the effective date of modification and assess the need for an updated discount rate. The lessor also would adjust the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification, recognizing neither a gain nor loss. (Under the Board's tentative decisions, a lessor would recognize a deferred inflow of resources equal to the present value of payments under the lease, and then recognize lease revenue rationally and systematically over the period of the lease.)

<u>Changes in Scope.</u> The Board tentatively decided to propose that for a lease modification resulting from an increase in scope, the lessee would remeasure the lease liability on the effective date of modification and assess the need for an updated discount rate. The lessee also would adjust the right-of-use asset by the difference between the modified liability and the liability immediately before the modification, recognizing neither a gain nor loss. On the lessor side, the Board also tentatively decided to propose that the lessor remeasure the lease receivable on the effective date of modification and assess the need for an updated discount rate. The lessor also would adjust the deferred inflow of resources by the difference between the modified receivable and the receivable immediately before the modification, recognizing neither a gain nor loss.

The Board then discussed lease modifications related to a decrease in scope. The Board tentatively decided to propose that the lessee would remeasure the lease liability on the effective date of modification and assess the need for an updated discount rate. The lessee also would adjust the right-of-use asset for the portion of the lease that is terminated and recognize a gain or loss for the difference. The lessor would remeasure the lease receivable on the effective date of modification and assess the need for an updated discount rate. The lessor also would adjust the deferred inflow of resources proportionally with the receivable adjustment and recognize a gain or loss on the difference.

Multiple Lease Components and Contract Combinations

The Board tentatively decided to propose that, in addition to separation of multiple lease components that have different lease terms, lessee governments would be required to separate multiple lease components in a contract if the underlying assets belong to different major classes. However, lessor governments would not be required to do so. A lessor already would have underlying assets recognized separately. The separation of components in a contract for lessors only would affect the lease receivable and deferred inflow of resources and neither of those items would require disclosure of separate information based on major class of underlying asset. Otherwise, lessors would separate lease and nonlease components or multiple lease components on the same basis as lessees.

The Board tentatively decided to propose that governments presume that contracts entered into at or near the same time with the same counterparty are not part of one arrangement, unless there is evidence to the contrary. The Board also tentatively decided to propose that contract combinations be required if one or both of the following criteria are met: (a) the contracts are negotiated as a package with a single objective or (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract.

Sale-Leasebacks

The Board began the September 8 teleconference meeting by discussing the general approach for the accounting and reporting of sale-leaseback transactions. The Board tentatively decided to propose that, as a general principle, a transaction should include a qualifying sale (as provided by Codification Section R30, "Real Estate," if applicable) in order to be accounted for using sale-leaseback guidance. The presence of an obligation or option for the lessee to repurchase the asset, however, would preclude the use of sale-leaseback accounting.

<u>Gains and Losses.</u> The Board tentatively decided to propose that any gain or loss in a sale-leaseback transaction would be deferred, regardless of how much use of the asset is retained by the seller-lessee. The entire gain in a sale-leaseback transaction would be treated as a deferred inflow of resources, rather than a reduction of the lease asset. If the leaseback is a short-term lease, any gain or loss would be recognized at the date of the sale, rather than deferred. The Board also tentatively decided to propose that the existing exception that recognizes a loss immediately for the difference between the fair value and undepreciated cost of the asset would not be retained.

<u>Off-Market Terms.</u> The Board tentatively decided to propose that an adjustment would be made for the off-market terms in sale-leaseback transactions. A government would be allowed to determine whether any off-market terms exist in a sale-leaseback transaction on the basis of the difference between either of the following, whichever is more readily determinable: (1) the sale price and the fair value of the underlying asset or (2) the present value of the contractual lease payments and the present value of the market rate lease payments. The Board also tentatively decided to propose that governments account for the off-market terms in the following manner: (a) treat any deficiency in

the same manner as a prepayment of the lease, and (b) treat any excess as additional financing provided by the buyer-lessor to the seller-lessee.

Accounting for Sale-Leasebacks. The Board tentatively decided to propose that the seller-lessee account for the leaseback under the same guidance to be proposed for lessees of leases that are not part of a sale-leaseback. If the transaction does not qualify for sale-leaseback accounting, the Board tentatively decided to propose that the seller-lessee (transferor) and the buyer-lessor (transferee) would both account for the transaction as a financing. The Board also tentatively decided to propose that the buyer-lessor would follow the applicable guidance for a capital asset purchase and the same guidance provided for lessors of leases that are not part of a sale-leaseback, as if the transactions were separate.

Note Disclosures. The Board tentatively decided to propose that seller-lessees would disclose the terms and conditions of the sale-leaseback transaction, but would not be required to disclose any gain or loss on the sale portion of the transaction separately from gains or losses on other capital asset disposals. Regarding failed sale-leaseback transactions, the Board tentatively decided to propose eliminating the guidance in paragraph 256 of Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, in which transferors disclose the minimum sublease rentals to be received in the future under noncancelable subleases.

Lease-Leaseback Transactions. The Board tentatively decided to propose special guidance for lease-leasebacks such that each party would recognize a net receivable and deferred inflow of resources or a net payable and lease asset. The Board also tentatively decided to propose that governments disclose the gross components of a net lease receivable or payable when there is a lease-leaseback transaction.

Fiduciary Responsibilities

The Board's deliberations on the Fiduciary Responsibilities project included a review of initial draft chapters of a Preliminary Views and a discussion of the organization of the description of a fiduciary that will be proposed in that due process document.

Deliberation of new issues focused on the reporting of fiduciary component units that have fiduciary component units of their own. At present, there is confusion as to the circumstances under which a component unit's own component units that are fiduciary in nature should be included in the financial statements of the primary government.

The Board tentatively decided to propose that when a primary government reports a fiduciary component unit in the fiduciary fund financial statements, the fiduciary component unit would be combined with its own fiduciary component unit and reported as a single fiduciary fund.

Tax Abatement Disclosures

The Board's discussion focused primarily on a first draft of the standards section of an Exposure Draft, Tax Abatement Disclosures. The discussion addressed transition provisions and effective date, as well as cost-benefit considerations.

Transition Provisions and Effective Date

The Board tentatively decided to propose that note disclosures would be required for the current and all prior periods presented. There would be an exception, however, if disclosure of the required information for those periods is not practical. In such circumstances, a government would explain why it was not practical to apply the Statement to those periods. The Board tentatively decided that the proposed standards would be effective for periods beginning after December 15, 2015, and would encourage earlier implementation.

Cost-Benefit Considerations

In addition to considering the costs and benefits associated with the individual decisions made during deliberations on proposed standards, the Board also reviews the expected costs and benefits of the proposed standards as a whole when a draft of a due process document or final pronouncement is first reviewed. The Board tentatively agreed that the benefits of the disclosures about tax abatements that will be proposed in the Exposure Draft would outweigh their perceived costs.

Irrevocable Charitable Trusts

The Board's deliberations on the Irrevocable Charitable Trusts project focused on recognition issues related to three scenarios: (1) direct donations to a government, (2) donations to a component unit of a government, and (3) donations to a third party that is outside the reporting entity for the benefit of a government. The Board also discussed issues specifically related to component units.

Direct Donations to a Government or a Component Unit

The Board discussed split-interest agreements in which a government or a component unit of the government holds and administers the resources—scenarios (1) and (2), respectively. The Board tentatively decided that these resources meet the definition of an asset in Concepts Statement No. 4, Elements of Financial Statements—resources with present service capacity that the government presently controls.

Donations to a Third Party outside the Reporting Entity

Next, the Board discussed split-interest agreements in which a third party outside the reporting entity holds and administers the resources and whether a government's beneficial interests in these split-interest agreements meet the asset definition. The Board discussed the elements of control and present service capacity that are required for those donated resources to be accounted for as assets of the government.

The Board tentatively decided to propose that donated resources held and administered by a third party (intermediary) outside the reporting entity are placed beyond the control of the donor, granting the government control over beneficial interests, when all the following criteria are met:

- The government (or a component unit of the government) is specified by name as beneficiary in the legal document underlying the donation.
- The government has a vested beneficial interest.
- The donation agreement is irrevocable.
- The donor has not granted variance power to the intermediary.
- The intermediary is not under the control of the donor (in the case of agency relationships).

The Board discussed a government's ability to monetize beneficial interests via assignment as a means to establish the present service capacity of such beneficial interests. The Board tentatively decided to propose that a government controls the present service capacity of beneficial interests if both of the following are true:

- The ability to assign beneficial interests is not subject to approval of the trustee or prohibited by

law.
- An actual attempt to assign beneficial interests does not invalidate the government's beneficial interests and therefore terminate the trust.

Revenue Recognition

The Board discussed whether to recognize revenue for beneficial interests. Even if the resources meet the definition of an asset of the government, the inflow of those resources is related to a future period, not to the period in which the donation agreement is finalized. Therefore, the Board tentatively decided to propose that the beneficial interests would be recognized as a deferred inflow of resources rather than revenue.

Component Unit Issues

The Board tentatively decided to propose that, in the case in which the component unit is the specified beneficiary of a split-interest agreement, the component unit would recognize an asset and a deferred inflow of resources, consistent with scenarios in which a government is the specified beneficiary. In the case in which a component unit holds and administers the resources of a split-interest agreement for the primary government, the component unit would recognize the donated resources and liabilities to both the nongovernmental beneficiary and the primary government. Consistent with prior tentative Board decisions, the Board tentatively decided to propose that the primary government would recognize an asset and a deferred inflow for its beneficial interests in the split-interest agreement in which the component unit holds and administers the resources.

MMA Municipal Issuer Brief - Private Dollars and Politics.

Read the Brief.

Municipal Market Advisors | Oct. 7, 2014 |

S&P Defends Higher Municipal Credit Ratings.

Over the last year, the credit agency upgraded 41 percent of local governments' ratings, drawing skepticism from some.

As rating agencies, following the financial crisis, have sought to maintain their credibility, the divergence between the ratings that those agencies have doled out to governments has increased. Over the last year the number of issuers that have one rating from Moody's Investors Service and a different one from Standard & Poor's (so-called split ratings) has increased to nearly half, or 46 percent of all investment-grade rated municipal bonds.

Much of the focus has been on S&P, which over the past year has upgraded about 1,600 local governments' ratings as it has applied its new scoring criteria. An upgrade means those governments will likely get a more favorable interest rate on their bond sales than they did in the past, ultimately helping that government save money on borrowing costs. S&P's shift toward higher ratings have drawn skepticism from some observers. But the agency's analysts this week said the higher level of upgrades are simply because after they took a peek under the hood, the local government sector is doing better than analysts initially thought.

Of the roughly 4,000 local governments S&P re-evaluated over the past year, 41 percent received a ratings upgrade, 55 percent received the same rating and 4 percent received a downgrade. S&P initially predicted a more negative picture before it started its reviews – analysts figured only one out of every three governments would get an upgrade while 10 percent would be downgraded. The unpredicted level of upgrades was largely due to the fact that initial predictions were based on old financial and economic data and didn't include any of the more subjective components of S&P's scoring criteria, said analyst Chris Krahe.

"Management is a key piece," Krahe said in a webcast presentation regarding the conclusion of the ratings re-evaluations. "We had conversations with management teams and those discussions bring about insights about plans they have, expectations for future years, [and so on]. That's a very key part of the qualitative analysis we took into account…that was not part of the initial predictions."

Better information also played a role, he added. Many of the unpredicted upgrades were due to things like getting new audited information or updated economic figures.

The ratings criteria had been tested and went through a public comment period in the year before S&P began using it to re-evaluate its government ratings. The new criteria scores municipalities in seven categories: management, economy, budgetary flexibility, institutional framework (governance), budgetary performance, liquidity and debt/liabilities. The score for economy counts for 30 percent of the total score; all other categories are given a 10 percent weight. Key changes in the scoring criteria included giving more weight to the local economy score and adding more factors to the management score to take into account performance under financial stress.

Meanwhile, counterpart Moody's is issuing more downgrades than upgrades and it's leading some to question S&P's tack. In July, a Janney Montgomery Scott issued a fiery note that wondered whether the divergence in ratings would lead to governments only publishing their best rating, a practice known as ratings shopping.

"I do not remember a time when I saw so many credits with not just a one-or-so-notch difference here and there, but multiple-notch differences in some cases," Tom Kozlik, the analyst who wrote the note, told Governing at the time. "This is not part of the typical ratings cycle, where sometimes one rating agency is a little higher and vice versa."

Struggling governments have certainly grabbed the headlines but S&P this week reiterated its view that the local government sector as a whole is "strong and stable" with a historically low default rate. Therefore, the agency's ratings reflect that strength. The ratings upgrades generally resulted in a percentage shift from government credits that S&P had previously rated in the single-A category moving up into the double-A category. (The triple-A category, the highest rating, also saw an increase in the number of governments that S&P qualified for that tier.) The portion of governments S&P rated at triple-B or lower (junk status) stayed the same.

"We don't want to appear unaware that there are pockets of stress that could occur, said analyst Lisa Schroeer. "But we wanted this framework to be written in a way that doesn't penalize the entire sector."

Others agree. "As an asset class, municipals have an extremely low default experience, higher ratings are better supported by the data," said the Aug. 25 issue of Municipal Market Advisors' weekly research brief (emphasis included). The brief added that S&P's approach to scoring governments' credit is more forward-looking than Moody's, which accounts for some of the divergence between the two.

Now that S&P has reevaluated its local credits, it plans on using the new data it has to issue more reports that look at broader themes and trends in local government.

GOVERNING.COM

BY LIZ FARMER | OCTOBER 9, 2014

lfarmer@governing.com | @LizFarmerTweets

Muni Yields Plunge to 16-Month Low on Strongest Demand Since May.

The $3.7 trillion municipal market is rallying for the fourth straight week, pushing yields to the lowest since May 2013 amid the strongest demand in five months.

Yields on benchmark 10-year munis have fallen 0.05 percentage point this week to 2.11 percent, data compiled by Bloomberg show. Top-rated 30-year bonds yield 2.97 percent, a 17-month low.

Investors added $762 million to muni mutual funds in the week through Oct. 8, the largest inflow since May 7, Lipper US Fund Flows data show. Tax-exempt debt is following gains across fixed-income assets as concern mounts that global growth is slowing. Ten-year Treasury yields are set for the biggest weekly drop in six months.

"Individuals like munis more than ever," Alan Schankel, a managing director at Janney Montgomery Scott in Philadelphia, said by telephone. "The flows are going to continue."

Munis have earned about 9 percent this year, outpacing a 4.7 percent gain in Treasuries, Bank of America Merrill Lynch data show.

The rally has been most pronounced in longer-maturity munis, with yields on benchmark 30-year debt sinking 0.17 percentage point in the past two weeks. The difference in interest rates between two- and 30-year bonds is 2.63 percentage points, the least in 17 months.

The drop in borrowing costs will benefit issuers from Rhode Island to Washington that are set to offer $6.7 billion in debt next week, Bloomberg data show. States and cities issued $6.1 billion this week. Bond markets are closed Oct. 13 for the U.S. Columbus Day holiday.

As the local-debt market rallied, the $3.8 billion iShares National AMT-Free Muni Bond exchange-traded fund rose to $110.32, the highest since May 2013.

BLOOMBERG

By Brian Chappatta Oct 10, 2014 9:01 AM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Mark Schoifet

WSJ: Puerto Rico to Sell $1.2 Billion in Notes on Unusual Terms.

Puerto Rico is expected to sell up to $1.2 billion of short-term notes this week to large banks that have agreed to hold the debt until it matures in June, forestalling the heavy selling that followed a bond sale in March.

Lenders including J.P. Morgan Chase & Co., Bank of America Corp. and Morgan Stanley have said they won't sell the debt, which is often sold by purchasing banks to bond funds and other buyers, according to people familiar with Puerto Rico's financing plans. The sale of short-term notes, rated below investment grade, is expected to be arranged by J.P. Morgan, the people said. The $3.5 billion of bonds in March were purchased largely by hedge funds.

The unusual requirement tied to the proposed sale of tax- and revenue-anticipation notes reflects the financially strapped territory's efforts to broaden its funding base and to avoid the market unrest that followed the March deal, some of the people said. Banks don't usually agree to such lockups because regulators have increased capital charges for holding debt rated below investment grade, a bid to discourage lenders from holding risky assets.

The debt matures in June and will pay 7.75% annual interest, according to a notice posted on the website of Electronic Municipal Market Access, known as EMMA. The relatively high interest rate reflects investor fears that the island's economy won't turn a corner before the government runs out of cash.

The sale would mark the first time Puerto Rico has raised money in public markets since passing a law in June that allowed agencies such as the island's power, water and highway authorities to restructure their debts. Those three agencies have almost $20 billion in outstanding debt, according to Barclays PLC. The law doesn't apply to Puerto Rico's general obligation or sales tax debt.

Representatives for J.P. Morgan, Morgan Stanley and Bank of America declined to comment.

Puerto Rico has about $73 billion in total debt, which is widely held by mutual funds, hedge funds and individuals, and the island needs market access to cover expenses, including more than $1.2 billion in debt service due this year.

By selling new bonds, Puerto Rico buys itself time to try to restart the economy, plug its budget deficit and to restructure the Puerto Rico Electric Power Authority, which owes about $9 billion.

The previous sale was billed as crucial to give the new administration of Gov. Alejandro Garcia Padilla breathing room. The sale came after major credit-rating firms downgraded Puerto Rico to junk status.

By issuing debt only to banks, Puerto Rico is broadening its pool of investors, as it plans to sell longer-term bonds in coming months and may need hedge funds and mutual funds to buy that debt, said Robert Donahue, managing director at research firm Municipal Market Advisors. The commonwealth also may have wanted to keep the bonds from trading immediately to avoid the risk that falling prices might undermine investor confidence, he said.

Hedge funds like Och-Ziff Capital Management LLC, Fir Tree Partners and Perry Capital LLC bought most of Puerto Rico's bonds in March. Some still own the debt, but many sold out within weeks. The bond traded 2,539 times in its first month after issue, declining in value by about 8% in that period, according to data from EMMA.

In comparison, a California bond sale in March traded 717 times in its first month, according to EMMA.

Banks buying the new notes, which include Barclays and Banco Popular, are willing to put the risky debt on their balance sheets because it pays an unusually high rate for short-term debt. A bond backing bankrupt Detroit's development authority that matures in July traded in recent days at a yield of about 4.25%, according to EMMA.

Agreeing to buy debt now could also win the banks business underwriting billions of dollars in future bond sales Puerto Rico hopes to sell to fund managers in the next 12 months, analysts said.

A representative of Barclays declined to comment. Representatives for Banco Popular didn't immediately return requests for comment.

THE WALL STREET JOURNAL

By MATT WIRZ And AARON KURILOFF

Updated Oct. 7, 2014 6:12 p.m. ET

WSJ: A Calpers Comeuppance.

A judge says the giant public pension isn't above bankruptcy law.

A major political battle line these days is between public-union pension funds and taxpayers who pay the bills. Taxpayers won a major victory late last week when federal judge Christopher Klein ruled that the California Public Employees' Retirement System (Calpers) isn't protected from cuts in the city of Stockton's bankruptcy trial.

This is big and hopeful news because pension costs are partly responsible for driving Stockton broke. Pensions equal nearly 40% of the city payroll and are growing. The San Joaquin Valley city will spend $28 million next year on pensions—twice as much as in 2012 when it declared bankruptcy—and $36 million by 2020. That's one in every five tax dollars.

Yet everyone is taking a hit in bankruptcy except Calpers. The city last year raised its sales tax by 0.75% to cover rising labor costs and hire more police. Creditors are taking big haircuts. Assured Guaranty, which insures about $121 million in pension obligation bonds, will recover about 50%. Franklin Templeton Investments has been offered a penny on the dollar for $35 million in bonds for public works.

Calpers has nonetheless threatened to foreclose on Stockton if it isn't paid in full. When municipalities default on their pension bills, state law lets Calpers freeze worker benefits and charge a "termination fee" to cover their unfunded liability. The law also gives Calpers a lien on municipal assets. Lo, Calpers is demanding a $1.6 billion termination fee if Stockton breaks its pension contract. Yes, billion.

In 2011 Calpers adopted a policy of discounting the termination fee at a rate tied to 10- and 30-year Treasurys in lieu of the 7.5% rate it ordinarily uses to calculate unfunded liabilities. This sleight-o--hand blows Stockton's $212 million unfunded pension liability up to $1.6 billion. Welcome to the Hotel Calpers. You can check out anytime you want, but you can never leave.

Judge Klein called Calpers's extortionist ploy a "golden handcuff," adding that "the city's contract with CalPERS could be rejected" and the "lien can be avoided." Once California lets a municipality file for Chapter 9, federal bankruptcy law under the U.S. Constitution's Supremacy Clause overrides state statutes. Otherwise, the judge noted, "the California Legislature can edit the federal law."

Alas, Stockton appears to prefer being handcuffed. City attorneys argue that severing ties with Calpers or reducing pension benefits would a cause a "mass exodus" of workers and "irreparably damage" its ability to recruit. But despite cutting pensions for future workers, Stockton in 2012 reported a record number of police recruits—1,300 for 17 positions.

The truth is that city politicians are handcuffed by the public unions that control Calpers, and bankruptcy does not void the city's requirement under state law to collectively bargain with the unions. Calpers quickly dismissed the judge's ruling as "not legally binding" in Stockton or precedential "in any other bankruptcy proceeding." Translation: Forget you, Klein. We own the politicians.

Yet other bankruptcy judges will likely reach the same conclusions. And later this month Judge Klein must still determine whether Stockton's bankruptcy plan is "fair and equitable." How is it fair for Stockton to pay Calpers 100 cents on the dollar while scalping Franklin and slashing payments to bondholders who financed the city's pensions?

Calpers warns that workers will be at risk if insolvent cities can use bankruptcy to impair pensions, but the bigger danger is if politicians are allowed to use Chapter 9 to protect unions while shorting other creditors. Judge Klein has it right.

THE WALL STREET JOURNAL

Updated Oct. 7, 2014 6:19 p.m. ET

Bank of America Top U.S. Muni Underwriter So Far in 2014.

Oct 1 (Reuters) – Bank of America Merrill Lynch remained the top senior underwriter of U.S. municipal debt in the first nine months of 2014, with 262 deals totaling $28.77 billion, Thomson Reuters data released on Wednesday showed.

That represented more than 13 percent of sales in a year in which issuance has shrunk. Bank of America, which was also top underwriter in 2013, was followed by Citi, which had 264 deals totaling $24.35 billion in the first nine months of 2014.

California issued the most debt in the first three quarters of the year, $5.04 billion spread across eight deals, according to the data, followed by Puerto Rico's single March sale of junk bonds totaling $3.5 billion. California is typically the largest borrower in the municipal market, and its sales in the first nine months of this year represented a 2.3 percent market share.

The big sales, though, were not enough to lift issuance of municipal bonds from their doldrums, as total issuance was down 9.8 percent from the same period in 2013.

Assured Guaranty insured the most municipal bonds, backing $7.4 billion debt in the first nine months of the year, the data showed.

After the financial crisis, when many insurers lost their AAA ratings, the number of guaranteed bonds dwindled. Recently, though, interest in insurance has ticked up. Insurers backed a total of $12.78 billion in deals, 56.3 percent more than they guaranteed in the first nine months of 2013.

Bank of China Ltd made a large entry into the business of providing letters of credit to municipal issuers, taking the top spot for the first nine months after providing no letters of credit through all of 2013. It gave the facilities to only two deals, totaling $459 million, but that represented nearly one-fifth of the amount of debt backed by letters of credit.

Wells Fargo Bank, which had been the top provider in 2013, slipped to second, backing $225.1 million in five deals.

Altogether, $2.37 billion in deals carried letters of credit, a 47.5 percent increase from the same period of 2013.

Wed Oct 1, 2014 4:47pm EDT

By Lisa Lambert

(Reporting by Lisa Lambert, editing by G Crosse and Dan Grebler)

The U.S. Army Corps of Engineers Explores the Use of P3s on Water Infrastructure Projects.

Earlier this year, the U.S. Army Corps of Engineers (the "Corps") expressed an interest in utilizing public-private partnerships for improving the nation's water infrastructure. This would be a new means to finance and manage projects for the Corps, which has not historically entered into these arrangements.

A public-private partnership, or "P3," is a contract between the public sector and private entities that results in greater private sector participation in the delivery and/or funding of a public project. In effect, P3s allow for more private investment and involvement in public contracts.

This arrangement is favorable to the public sector, as the private partner will often bear the burden of financing the project. The private partner is then repaid, over time, through a specified mechanism. Often, the project itself creates a new revenue source. For example, a highway project may involve the addition of new tolls. The revenue from the tolls would be used to pay the private partner over many years (sometimes decades) after project completion.

States and municipalities have found success in implementing P3s for various project types, including facilities and transportation work. Recognizing the need for additional funding to support an overhaul of the nation's waterways and ports, the Corps is now interested in exploring the use of P3s as well. Private investment in public infrastructure would allow the Corps to address funding gaps and deliver projects at a faster rate.

To this end, the Water Resources Reform & Development Act of 2014 establishes a P3 pilot program – allowing private entities to participate in the financing, design, and/or construction of the Corps' water infrastructure projects. The Corps is now examining how to best attract private partners to participate in these projects, and what delivery models would yield the most effective and efficient results.

Over the years, the Corps will be required to report on its progress in utilizing the P3 pilot program. The Corps' success may encourage the use of P3s on other large federal projects, revolutionizing the way that these projects are financed and managed.

Last Updated: September 26 2014
Article by Sonia Tabriz
Fox Rothschild LLP

S&P: Stockton Judge's Pension Comment to Have Modest Influence on U.S. Municipal Bankruptcy Filings.

SAN FRANCISCO (Standard & Poor's) Oct. 2, 2014–U.S. Bankruptcy Judge Christopher Klein's statement on Oct. 1 that a final plan of adjustment for Stockton, Calif. to exit bankruptcy protection can include reduced payments to the California Public Employees Retirement System (CalPERS) could increase the appeal of bankruptcy for some distressed municipalities, but Standard & Poor's Ratings Services expects overall municipal bankruptcy filings to remain rare.

More pertinently, will the theoretical ability to reduce pension costs (with many legal uncertainties to be navigated and litigated) induce a significantly larger number of local governments to enter bankruptcy? In short, we believe the answer is no. However, the statement by Judge Klein, of U.S. Bankruptcy Court for the Eastern District of California, could prove meaningful for a very small portion of distressed municipalities nationwide as they contemplate potential avenues to address mounting budget and liquidity pressures with little room to navigate.

Judge Klein's decision also highlights the uncertainties that municipalities and their stakeholders face in the interaction between state and federal laws in bankruptcy. Our observation is that many Chapter 9 municipal bankruptcy cases are settled without creating legal precedent. Judge Klein has not ruled yet on Stockton's proposed plan of adjustment. However, we believe that he signaled that the city could propose (although to date, it has not) as part of its future exit from bankruptcy cuts to pension contributions with unclear effects on what benefits retirees would receive. This could prove meaningful for some municipalities considering bankruptcy. The implicit outcome, however uncertain it may be, could help frame their negotiations with employees on potential changes to retirement benefits as partial solution to mounting budgetary pressures.

In practice, however, we believe any material benefits to a municipality's credit quality from Judge Klein's statement are likely to be quite muted. There are several reasons for this.

First a bankruptcy filing is necessary but not sufficient for a municipality to abrogate its employee contracts under the judge's statement. Second, we believe the bankruptcy process is the start of a negative campaign that once underway puts the municipality in question immediately and substantially in a distant place from its peers in regard to popular perception, market access, and viability of long-term provision of services.

In our view, municipal bankruptcy continues to carry a substantial stigma because it signals that management has abdicated its role as a steward of a community's financial resources and sets in motion what is often a long and costly process. Moreover, the likely negative effects of bankruptcy on a community's long-term economic growth prospects can further impair the municipality's ability to recover financially. Standard & Poor's laid out these negative effects in more detail in the article, "Detroit's Bankruptcy Filing Is Becoming A Long And Costly Row To Hoe," published Dec. 3, 2013. We continue to believe that very few obligors would seriously consider bankruptcy as an option in a large and broad municipal market.

Although we have witnessed three California cities, including Stockton, file for bankruptcy protection in the past five years, we believe that credit quality in the state is stable overall, with most California cities having shown the ability to make difficult budget adjustments during the Great Recession to bring expenditures in line with revenues.

Primary Credit Analyst: Chris Morgan, San Francisco (1) 415-371-5032; chris.morgan@standardandpoors.com

Secondary Contacts: Horacio G Aldrete-Sanchez, Dallas (1) 214-871-1426; horacio.aldrete@standardandpoors.com

Misty L Newland, San Francisco (1) 415-371-5073; misty.newland@standardandpoors.com

Matthew T Reining, San Francisco (1) 415-371-5044; matthew.reining@standardandpoors.com

---

S&P: The Updated General Obligation Criteria Reflect the U.S. Local Government Sector's Strength and the Importance of Qualitative Analysis.

In the past year, Standard & Poor's Ratings Services applied its general obligation (GO) local government criteria to more than 4,000 U.S. local government issuer credit ratings and ratings on GO bonds issued by municipal governments that are not special purpose districts. We included cities, counties, towns, villages, townships, and boroughs. Of those local government ratings, 55% did not change. We raised 41% of our ratings and lowered 4%. Most of the ratings changes (69%) were by one notch (see chart 1), which closely matches our expectations from when we released our criteria on Sept. 12, 2013. However, overall rating actions do differ slightly from our estimates we gave when we released the criteria (60% unchanged, 30% upgraded, and 10% downgraded). We attribute the difference to qualitative analysis and updated information

When we first envisioned the criteria update, we had three key goals in mind. First, we wanted to facilitate greater comparability of ratings across geographies and sectors by recognizing and incorporating the overall strength and stability that the local government sector has demonstrated. Second, we sought to enhance the transparency of our ratings methodology, including a clear explanation of qualitative adjustments — which go beyond the numbers and can have a significant impact on an issuer's creditworthiness. Finally, we wanted to formalize and make explicit the forward-looking components of our analysis.

Continue reading.

MMA Municipal Issuer Brief - September 29, 2014

Read the Brief.

Insurers Build Market Share as Detroit Shows Value: Muni Credit.

Municipal bond insurers are capturing the most market share since 2009 as Detroit's bankruptcy and Puerto Rico's struggles underscore the value of the coverage to investors in the $3.7 trillion market.

About 5.2 percent of the $248 billion in munis issued this year through September carried insurance, up from 3.2 percent in 2013 and the highest in five years, data compiled by Bloomberg show. Before the financial crisis cost insurers their top ratings amid losses on guarantees of subprime-mortgage debt, more than half the market had the backing.

The coverage has proven its worth in the past year as insured bonds from Detroit and Puerto Rico issuers retained their value while uninsured debt sank. In a sign of the revival, MBIA Inc. (MBI) said yesterday that it hired muni analyst Tom Weyl from Barclays Plc.

"Detroit and Puerto Rico have both shown the marketplace that there's value in solid bond insurers," said Rick Taormina, head of muni strategies in New York at J.P. Morgan Asset Management, which oversees $53 billion in local debt. "You could start to see a movement towards 10 to 15 percent of bonds insured over an economic cycle."

Weyl Hire

Weyl, formerly director of muni research at Barclays in New York, will start by year-end as managing director and head of new business development at National Public Finance Guarantee Corp., MBIA's muni-bond insurance unit in Purchase, New York.

He's the latest muni analyst to bet on an insurance revival. John Hallacy last year joined Assured Guaranty Ltd. (AGO) as managing director of public finance after stepping down as Bank of America Merrill Lynch's head of muni research.

Weyl didn't respond to a voicemail left at his Barclays office number. Mark Lane, a spokesman at Barclays in New York, declined to comment.

In August, National backed its first new bond offering since 2008, according to Bloomberg data. It guaranteed portions of a $1.8 billion deal from the Michigan Finance Authority on behalf of the Detroit Water and Sewerage Department. Assured Guaranty Municipal Corp. also backed some of the debt.

National Benefit

National’s backing drove down yields on the Detroit bonds. A portion due in July 2017 with National insurance priced to yield 1.24 percent, while uninsured debt with the same maturity yielded 1.49 percent.

Investors expected National to back new bonds after Standard & Poor’s raised its rating in March to AA-, fourth-highest and one level below units of Assured and Build America Mutual Assurance Co., the market’s primary insurers.

“Events over the past year have helped to refocus the market on some of the important benefits of Assured Guaranty bond insurance,” Robert Tucker, head of communications and investor relations in New York, said by e-mail. “Those benefits include greater price stability and improved market liquidity, along with the certainty of timely payment of debt service and our ability to work with an issuer to resolve its difficulties.”

In one example, Puerto Rico general obligations with Assured’s protection and due in July 2024 traded this week at 100 cents on the dollar, while debt with the same maturity that doesn’t have insurance traded Sept. 26 at 73 cents on the dollar.

Storytellers Sought

S&P said in March that insurers may double their market share to 8 percent of issuance this year. Municipal Market Advisors, a Concord, Massachusetts-based research firm, said in the same month that 5 percent was a probable target.

As soon as next week, Stockton, California’s public-financing authority plans to issue $71 million of wastewater revenue debt with insurance from Build America Mutual, offering documents show.

The city, which sought bankruptcy protection in 2012, has treated enterprise securities such as the water debt as unimpaired, meaning investors will get paid in full, bond documents show. S&P rates the underlying bonds A-, seventh-highest, while the Build America backing boosts the grade to AA, third-best.

National will probably guarantee more new bond sales, and the competition among three companies instead of just two will further boost insured volume, said Alan Schankel, a managing director at Janney Montgomery Scott LLC in Philadelphia.

“When National attracts somebody like Tom Weyl, much like Assured brought in John Hallacy, that’s part of an overall effort to get out and tell their story,” he said. “For insurers, their challenge is marketing now. They have a good story: Stockton, Detroit and other distressed situations have seen investors benefit from having insurance.”

Bloomberg

By Brian Chappatta Oct 2, 2014 5:00 PM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Alan Goldstein

Fitch: Stockton Bankruptcy Ruling Opens Door to Pension Cuts.

Fitch Ratings-New York-02 October 2014: A federal judge's verbal ruling yesterday that Stockton's payments to the California Public Employees' Retirement System (CalPERS) may be impaired is consistent with our view of pension liabilities in the bankruptcy of a municipality, Fitch Ratings says. Payments to pensions may be protected by anti-impairment language in state law, but in a federal bankruptcy proceeding they are at risk for impairment like any other liability. The ability to impair otherwise protected obligations to reset a debtor's financial profile is a key premise of municipal bankruptcy law. Bankruptcy protection provided to special revenue obligations and the preservation of statutory liens under the federal law are not affected by this outcome.

If established as a precedent, the Stockton ruling may increase incentives for distressed municipalities to seek pension cuts in bankruptcy court. However, Fitch believes those seeking bankruptcy protection will do so whether or not they can be certain of their ability to impair pensions. More likely in Fitch's view is that the ruling may encourage labor and management to negotiate pension cuts to avoid the uncertainties of bankruptcy court.

Our basic approach to ratings is therefore unaffected. The ruling supports our view that unfunded pension liabilities and high and increasing pension contributions are a risk that must be accounted for in any credit evaluation.

The impact of the ruling for Stockton's employees may be minimal, as the city has proposed no pension benefit reductions for CalPERS members. Local officials contend that previously enacted reductions to employee and retiree health benefits have already been substantial, and that further retirement benefit cuts would hurt Stockton's ability to attract and retain employees. In contrast, Detroit has proposed to reduce benefit payments to pension system members although to a lesser extent than for general government debt holders. The Stockton ruling might raise the bar for bankruptcy plan confirmation as the court must determine it is fair and equitable without pension impairment despite other creditor objection.

The Stockton ruling follows several attempts by well-functioning California municipalities with large long-term liabilities to reduce pension costs. Efforts to impose pension cuts through voter initiatives in San Jose and San Diego have been delayed by litigation and the legality of such reductions outside of bankruptcy under California and other state constitutions remains unclear.

Contact:

Stephen Walsh
Director
+1 415 732-7573
Fitch Ratings, Inc.
650 California Street
San Francisco, CA 94108

Amy Laskey
Managing Director
+1 212 908-0568

Rob Rowan
Senior Director
Fitch Wire

+1 212 908-9159

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

Judge Says Cities in Bankruptcy May Reject Pension Contracts.

The federal judge overseeing the bankruptcy of Stockton, Calif., ruled that the city has the power to cut its pension obligations, a landmark decision that has implications for workers, investors and troubled municipalities across the country.

U.S. Bankruptcy Judge Christopher Klein ruled Wednesday bankruptcy laws give Stockton the power to cut ties with California Public Employees' Retirement System, or Calpers, which controls city workers' retirement money as the country's largest public pension fund. Judge Klein said that the section of the U.S. Bankruptcy Code that allows distressed cities and companies to break contracts is one of bankruptcy law's core powers.

"Pensions could be adjusted," Judge Klein said from his Sacramento courtroom.

Payments into pension funds are usually considered sacrosanct, but Judge Klein is the second judge to rule recently that they may be cut. In December, the judge overseeing Detroit's bankruptcy case ruled that such obligations aren't entitled to "extraordinary protection" despite state constitutional safeguards against benefit cuts.

"These rulings are going to carry a lot of weight," said Patrick O'Keefe, a Bloomfield Hills, Mich.-based financial consultant who has worked on municipal turnarounds but isn't involved in Stockton's case. If judges decide that bankrupt cities in Michigan and California can reduce their pension obligations, "what stops Chicago or Los Angeles from doing the same thing?"

The decision is a blow to the state's retirement system, which has argued pension payments are guaranteed by California law and can't be cut. Stockton contributes roughly $30 million a year to

Calpers, which controls retirement money for municipal workers across California and has assets of roughly $294 billion.

In a statement, Calpers officials said they disagree with Judge Klein's ruling on pension impairment.

"This ruling is not legally binding on any of the parties in the Stockton case or as precedent in any other bankruptcy proceeding," the statement said.

Judge Klein didn't say Wednesday whether Stockton, which has 300,000 residents, can leave bankruptcy with a plan that doesn't cut the city's pension contributions. He said he would read his decision at an Oct. 30 hearing.

Stockton's bankruptcy lawyers said that Judge Klein should approve the plan, arguing after Wednesday's ruling that city workers have sacrificed enough.

The city cut its workforce by 30% before filing for bankruptcy in June 2012. Through a major deal on health care cuts, more than 1,000 workers and retirees who had $538 million in claims against the city agreed to accept one-time payments worth $5.1 million instead.

Throughout the city's bankruptcy, Stockton lawyers fought off pressure to make pension cuts to free up money to repay a bondholder's $37 million claim. Two funds managed by Franklin Templeton Investments, which extended the bonds for the city's fire stations and parks, argued that the city's long-term projections show that it could afford to repay more than the city's $4 million offer.

City lawyers argued that the Stockton would have to pay a $1.6 billion termination fee and that city workers would quickly find other jobs once the pension contract ends.

"The city cannot impair pensions and continue to function as a city," Marc Levinson, the city's bankruptcy lawyer, said at Wednesday's hearing.

During Wednesday's hearing, Judge Klein said Stockton has the option to leave the Calpers pension system and find a potentially cheaper option with another municipality or the private sector.

"The whole world is out there for a California municipality in terms of how it wants to handle its pensions," Judge Klein said.

Stockton filed for bankruptcy protection in June 2012 after losing tax revenue during the real-estate downturn—Judge Klein called the city "ground zero" for the subprime-mortgage crisis—and after borrowing money for new projects that it couldn't afford. Judge Klein also said that former leaders at the city, located about 80 miles inland from San Francisco, also offered overly generous pay to city workers.

Stockton's bankruptcy marked the second-largest financial failure by a U.S. city and one of several California cities, including San Bernardino and Vallejo, to seek Chapter 9 protection in recent years due to mounting pension obligations and the fallout from the financial crisis.

THE WALL STREET JOURNAL

By KATY STECH and DAN FITZPATRICK

Updated Oct. 1, 2014 8:04 p.m. ET

MSRB Makes Kroll Bond Ratings Available to the Public through its EMMA Website.

The Municipal Securities Rulemaking Board (MSRB) announced today that its Electronic Municipal Market Access (EMMA®) website now provides free public access to public finance ratings from Kroll Bond Rating Agency (KBRA).

View the full press release.

Moody's Sees Continued Public Pension Funding Gaps.

Despite strong investment returns and reform measures, public pension funds are losing ground in dealing with unfunded liabilities, Moody's Investors Service said in a report issued Thursday.

Between 2004 and 2012, Moody's calculated that the pension systems' unfunded liabilities tripled to an estimated $1.99 trillion, with a compound annual growth rate of 17.7% for the period, in part because of inadequate sponsor contributions.

The contribution shortage will continue to grow as public plan sponsors shift to a new pension accounting and disclosure regime from the Governmental Accounting Standards Board, Moody's warned. Since it emphasizes investment returns over annual contributions, "the resulting funding disincentive is at the core of the public-sector pension asset-liability gap," said Al Medioli, senior credit officer, in a statement about the report.

Another factor, Mr. Medioli said, "is that it is inherently difficult to recover an overall asset position after the double-digit losses seen during the recession. Annual returns may be strong, but incremental gain is small relative to pre-downturn levels because the investment base is so much smaller." Liabilities also face pressure from shifts to riskier asset allocations and an aging population, Moody's said in the report.

Keith Brainard, research director of the National Association of State Retirement Administrators, questioned Moody's choice of time frame to analyze. "It seems selective and not updated," Mr. Brainard said in an interview. "A better time frame would be one that begins to reflect two important variables: improving investment markets and the effect of the pension reforms that virtually every state has enacted."

"We are on the verge of improving pension funding levels. That improvement we expect to be sharp," Mr. Brainard said.

BY HAZEL BRADFORD | SEPTEMBER 25, 2014 3:51 PM | UPDATED 3:55 PM

— Contact Hazel Bradford at hbradford@pionline.com | @Bradford_PI

Real Estate Munis Coveted in Riskless Return Chase.

Debt backed by real estate is the best-performing part of the $3.7 trillion municipal market this year when factoring in price swings as housing foreclosures ebb.

Land-backed munis, known as dirt bonds, earned 10.3 percent this year through Sept. 23, beating the 7.7 percent advance for all munis, according to S&P Dow Jones Indices. After accounting for volatility using Bloomberg's risk-adjusted return calculator, the real-estate securities have gained 7.5 percent, exceeding the 5 percent advance for the whole market.

Debt repaid from land districts, mostly in Florida and California, is profiting as the housing market strengthens amid a recovering economy, said John Miller, co-head of fixed-income at Nuveen Asset Management LLC in Chicago. Foreclosure filings have averaged about 111,000 the past three months, down from a peak of 367,000 in 2010, according to RealtyTrac Inc.

"You have a more stable and steady improvement in the demand for new homes that are constructed today within these districts," said Miller, who helps manage $94 billion of munis, including $4.9 billion of dirt bonds. "There's good income coming from the bonds with relatively low volatility."

Fee Backing

Munis backed by real-estate projects are issued to help finance construction and are repaid with assessment fees charged to homeowners.

The housing crisis that deepened during the recession caused some developments financed with munis to fall into payment default. Of the 448 active municipal defaults as of Sept. 10, in which issuers hadn't made full payments, about half were for land-secured debt, according to Municipal Market Advisors, a research firm based in Concord, Massachusetts.

The bulk of distressed land-backed munis came to market from 2005 to 2007 for home developments in Florida called community development districts, Miller said. Many of the securities have reworked payment schedules to revive construction, he said.

"The bonds were restructured in some way," Miller said. "The development restarted and it's no longer as much distressed."

The entire housing market is on the upswing. New homes sold in August at the fastest clip since 2008, Commerce Department figures showed yesterday.

Backyard Buyer

For Jason Diefenthaler at Wasmer, Schroeder & Co. Inc. in Naples, Florida, the development districts are often a car-ride away. The firm oversees $3.5 billion of munis. Its $63 million High Yield Municipal Fund, has 7.5 percent of assets in land-backed debt, Diefenthaler said.

"We have a lot of these deals in our backyard," Diefenthaler said. "We have the ability to hop in our car, call the developer, go over get a site visit and talk to the finance team to see where sales are going."

Land-backed securities are gaining as investors seek riskier debt for higher yields compared with top-rated munis, Diefenthaler said. Yields on benchmark 10-year munis maturing in 10 years, at 2.25 percent yesterday, fell to the lowest since May 2013 this month, data compiled by Bloomberg show.

High-yield munis, a category including land-backed debt, have gained 13.2 percent this year, S&P data show.

Roll Tide

“What we’ve had is really a rising-tide scenario,” for high-yield munis, Diefenthaler said.

Wasmer Schroeder prefers developments in wealthier areas along Florida’s coasts, he said. The state’s community development districts fold assessment fees into property-tax bills, making it more likely that homeowners will make full payments, he said.

“Your repayment mechanism is really very tax-like,” Diefenthaler said.

Wasmer Schroeder in April bought dirt bonds sold by the Midtown Miami Community Development District, he said. The district sold $91.8 million of unrated, tax-exempt bonds to refinance debt it sold in 2004 to help fund parks, roadways and parking facilities, according to bond documents.

Nuveen held about $42 million of the bonds as of Aug. 31, Bloomberg data show.

The performance of the bonds since their sale five months ago underscores the demand for the category. Debt maturing in May 2037 traded with an average yield of 4.88 percent on May 21, down from 5.25 percent when it was sold April 22.

“That was tremendously oversubscribed,” Diefenthaler said of the deal. “We got a fraction of the bid that we put in.”

Bloomberg

By Michelle Kaske Sep 24, 2014 5:00 PM PT

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Alan Goldstein

---

Toll Road Bankruptcy Reflects Growing Pains of P3 Sector, S&P Says.

WASHINGTON D.C. (Standard & Poor’s) Sept. 23, 2014–The bankruptcy filing of the Indiana Toll Road on Sept. 22, 2014, may be the result of an overaggressive capital structure that shifted too much risk to private investors, according to analysts from Standard & Poor’s Ratings Services. The Indiana Toll Road, which Standard & Poor’ did not rate, was an early-stage public private partnership (P3) transaction in the U.S. We do not believe this bankruptcy will slow the growth of current-generation transportation P3 projects, which have different risk characteristics.

The Indiana Toll Road is one of several “brownfield,” or existing, road transactions that relied on overly optimistic traffic volume projections to support an aggressive capital structure. A consortium of investors bought the right to operate the road in 2006, while the Indiana Finance Authority retained physical ownership. Similar projects were more common before the economic downturn and some analogous projects have had difficulty achieving their projected traffic forecasts in recent years.

“These types of deals, which feature an accreting debt structure, are not seen in the marketplace today, but were commonplace in the first generation of these toll-risk projects–what you might call ‘Version 1.0’ of public-private partnerships,” said Steve Dreyer, managing director of the U.S. Utilities & Infrastructure Ratings practice at Standard & Poor’s. “Investors and project sponsors have addressed risks differently in more recent transactions, which itself was a driving force behind our newly updated project finance rating methodology. This evolution is both expected and natural, and in our view will ultimately help bridge the substantial financing gap between government resources and public infrastructure needs.”

Standard & Poor’s will host a discussion on the risks associated with financing public-private roadways like the Indiana Toll Road at its 55 Water Street offices on Thursday, Sept. 25. The discussion, entitled “Traffic and Revenue Forecasting: Is This Risk Too Much For The Private Sector To Bear,” is held in conjunction with the International Project Finance Association. Members of the media are invited to attend by registering through the association’s website.

Analysts from the Utilities & Infrastructure practice will be available to discuss the sector with reporters in attendance.

Forecasting traffic demand remains the key risk for P3 toll road and managed lane projects. Standard & Poor’s newly released project finance criteria focus in detail on these major risks for volume-exposed P3s. Projects with well-established demand, few competing routes, and reasonable toll rates supporting sustainable traffic and revenue growth have been able to achieve investment-grade ratings.

Standard & Poor’s publicly rates eight P3 road transportation projects in the U.S., of which half (Elizabeth River Crossings Opco LLC, 95 Express Lanes LLC, and NTE Mobility Partners Segments 3 LLC, and Autopistas Metropolitanas de Puerto Rico LLC) rely on toll revenues. The rest are availability projects where the project is not exposed to volume risk. Under an availability P3, the project does not take volume risk. Instead, a typically high-rated state agency awards the right to a project to build and operate the road and the project receives regular government payments if it meets key performance targets. Recent examples of rated availability transactions include I-4 Mobility Partners Opco LLC, and I-69 Development Partners LLC. For volume and availability transport P3s, the U.S. lags other regions around the globe, where we have assigned about 45 ratings to privately owned transportation projects.

The number of U.S. P3 projects has been growing in recent years. Notably, Virginia, Texas, Florida, Indiana, and Colorado are deploying P3 projects, including investor-owned toll roads, and 33 states and Puerto Rico have enabled P3 legislation.

Under Standard & Poor’s policies, only a Rating Committee can determine a Credit Rating Action (including a Credit Rating change, affirmation or withdrawal, Rating Outlook change, or CreditWatch action). This commentary and its subject matter have not been the subject of Rating Committee action and should not be interpreted as a change to, or affirmation of, a Credit Rating or Rating Outlook.

Standard & Poor’s Ratings Services, part of McGraw Hill Financial (NYSE: MHFI), is the world’s leading provider of independent credit risk research and benchmarks. We publish more than a million credit ratings on debt issued by sovereign, municipal, corporate and financial sector entities. With over 1,400 credit analysts in 23 countries, and more than 150 years’ experience of assessing credit risk, we offer a unique combination of global coverage and local insight. Our research and opinions about relative credit risk provide market participants with information and independent benchmarks that help to support the growth of transparent, liquid debt markets worldwide.

Primary Credit Analysts:

Steven J Dreyer, Washington D.C. (1) 202-383-2487;
steven.dreyer@standardandpoors.com

Anne C Selting, San Francisco (1) 415-371-5009;
anne.selting@standardandpoors.com

Jodi E Hecht, New York (1) 212-438-2019;
jodi.hecht@standardandpoors.com

Media Contact:

Olayinka Fadahunsi, New York (1) 212-438-5095;
olayinka.fadahunsi@standardandpoors.com

MMA Municipal Issuer Brief - September 22, 2014

Read the Brief.

Why Don't More Cities Sell Air Rights?

Vertically inclined cities could make a lot of money allowing private developers to build high-rise apartments or business spaces above libraries, city halls and schools.

Public works projects often come at heavy expense. Whether it’s building new schools, municipal halls or other facilities, such projects produce not only upfront costs, but depending on their magnitude, long-term debts. There is, however, a way to mitigate costs, or even make a project more profitable: Sell off the air rights.

This is an idea that, while holding vast economic potential, is used sparingly in America. Nowadays whenever cities build a central library, to name one example, they usually construct a single-use facility that is only a few stories tall, if that. But what if, before such libraries were built, the air rights — the undeveloped space above the roofline — were deregulated and sold off? In expensive and vertically inclined U.S. cities, private developers would pay governments enormous sums for the right to build a high-rise apartment complex or business space above public projects. This would lead to the broad maximization of public land values, and thus to enormous cash windfalls for local governments.

So why don't more cities sell air rights? It's a good question in these fiscally challenging times. Since the 1980s, the Massachusetts Bay Transportation Authority has granted development rights above its facilities in Boston. For instance, it has sold the air rights above the North Station transit terminal for $20 million plus the cost of extensive repairs to the station. Now, a new deal above the Back Bay Station is being negotiated. Other major cities have also allowed vertical development over transportation infrastructure, most famously in New York City, when the Pan Am Building went up above Grand Central Terminal.

Generally, though, U.S. cities do not maximize their use of public properties. Walk through any city and you'll find countless examples of where modestly sized government buildings have been plopped down onto prime real estate. In Seattle, for example, substantial public money has recently gone toward a new library, City Hall and renovated convention center, none of which exceed a dozen stories in an otherwise vertical downtown.

It is in compact cities such as Seattle — along with Boston, Chicago, New York City, San Francisco and Washington, D.C. — where utilizing air rights would make the most sense. The returns would be substantial in such hot real estate markets, and besides, compact cities are best equipped to handle added density. After all, if proposed three-story schools, libraries and recreation centers could instead sit inside 50-story mixed-use towers, this would increase the supply of affordable housing and office space, further compelling people to locate centrally.

Of course, barriers now exist to making the sale of air rights a common practice. Zoning regulations — along with neighborhood opposition — often prevent public buildings from mixing with private purposes or becoming too large. But the true barrier may be a philosophical one within governments themselves. For too long, many officials have not viewed public properties as crucial assets that should be used efficiently. Selling air rights would be a step in the right direction.

GOVERNING.COM

Scott Beyer | Contributor
BigCitySparkplug@yahoo.com

[GASB User Survey on the Effectiveness of Statement 34.]

Feedback from those who need financial information about state and local government financial statements is vital to Governmental Accounting Standards Board's (GASB') efforts to improve financial accounting and reporting. The GASB is currently conducting pre-agenda research to inform its assessment of the effectiveness of Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and related standards. The objective of this research is to gather feedback on these broad questions:

- What Statement 34 requirements related to management's discussion and analysis, government-wide financial statements, fund financial statements, and budgetary comparison information are effective or ineffective in providing information that is essential for decision-making and that enhances the ability to assess a government's accountability?
- What concerns exist regarding the application of the standards?
- How do the costs of applying the standards compare with the perceptions of the benefits of the

resulting information?

Statement 34 has a pervasive influence over the effectiveness of financial reporting by state and local governments and the ability of that reporting to achieve the objectives of financial reporting. As a result, the GASB decided that it was important, as part of its commitment to maintaining the effectiveness of its standards, to reexamine the current financial reporting model now that it has been in place for a sufficient length of time. This survey is one effort in the planned pre-agenda research to be conducted by the GASB staff.

The GASB has developed an online survey to gather feedback from users of governmental financial information. The GASB would greatly appreciate you taking the time to complete the survey, which can be accessed by following this link.

It is anticipated that the survey will take longer than a typical GASB survey, given the magnitude of the requirements of Statement 34. It is vital, however, that the GASB receive your feedback in order to assess whether Statement 34 has resulted in you receiving the information you need. To make it easier to complete the survey, it is possible for you to download a copy of the survey in its entirety to consider the questions before entering your responses into the online version. Additionally, you do not have to complete the online survey in a single session. You can save your responses and will be provided an individualized link to return to your survey at a later date to complete it.

You are asked to complete the survey by Friday, October, 10, 2014.

Your input is essential to the GASB's standards-setting process. If you have any questions, please feel free to contact Roberta Reese (rereese@gasb.org) or Lisa Parker (lrparker@gasb.org).

GFOA Executive Board Approves Four Best Practices.

The GFOA's Executive Board approved three new best practices and one revised best practice on September 22, 2014. These documents provide recommendations to government finance officers in the areas of accounting, retirement benefits administration, and debt issuance.

Coordinating the Work of Multiple Auditors. This new best practice provides recommendations to facilitate the effective, efficient, and timely performance of group audits – when a portion of a government's financial report is audited by other auditors. Appropriately coordinating auditing functions ensures that there won't be delays in the delivery of financial statements, which is important because delays could result in additional costs or modified opinions.

Enhancing Reliability of Actuarial Valuations for Pension Plans. Actuarial information directly affects the funded level and sustainability of pension plans, and this new best practice urges pension plan fiduciaries to ensure that all the information provided to the actuary is accurate and up to date. The document also provides guidance on engaging actuaries and information about additional services that finance officers should consider having the actuary perform.

Investment Fee Policies for Retirement Systems. The GFOA developed this best practice to help pension funds minimize the impact of investment management fees on portfolio returns. It recommends that retirement systems, especially those that use alternative investment strategies, adopt an investment management fee policy that will provide for negotiating the lowest competitive fee possible while looking out for the system's long-term earning potential. The best practice also recommends strategies for reducing investment fees.

[Investment of Bond Proceeds.](#) The GFOA updated this best practice to alert governments to the Security and Exchange Commission's classification of brokers as Municipal Advisors under the SEC Municipal Advisor Rule (MA Rule), in certain instances. The MA Rule, which went into effect in July 2014, permits brokers to provide general information without being considered MAs; however, broker-dealers will be deemed to have provided "advice" when they recommend that their government clients buy a particular security. The updated best practice provides recommendations on how to engage brokers for investing bond proceeds, in light of the new rule.

Century of Debt Suiting Ohio State at These Rates.

Ohio State University is joining issuers going into hock for 100 years as dwindling borrowing costs kindle the appeal of locking in interest rates for a century.

The school, with its main campus in Columbus, may sell $150 million in taxable century bonds as soon as this week. It will issue as the relative cost of borrowing for longer periods is shrinking: Thirty-year debt yielded as little as 0.83 percentage point more than 10-year bonds last week, the smallest gap since 2012, data compiled by Bloomberg show.

Even with the advantageous rates, century bonds are rare because they rely on confidence that the issuer will be around in 100 years. While top-rated universities have been the primary users of the securities, interest rates close to generational lows have brought more deals to market. Last week, the Cleveland Clinic became the first not-for-profit health-care system to borrow for a century. In July, the first U.S. public utility sold the securities.

"Century bonds give the ultimate flexibility when it comes to having cost of capital set for a very long period of time," said Michael Papadakis, treasurer of Ohio State, which was established in 1870. "As a public university, we don't have equity, so this is the longest capital you can get."

Century Club

This would be Ohio State's second century offer. In 2011, it became the first public school to issue 100-year taxable debt when it sold $500 million. In earlier issues, Walt Disney Co. (DIS) sold centuries in 1993 and the Port Authority of New York and New Jersey followed a year later. Yale University and the Massachusetts Institute of Technology have sold centuries into the corporate market. So has railroad Norfolk Southern Corp.

Ohio State is determining whether to issue taxable bonds due in 2114 or tax-free securities due in 30 years, Papadakis said. The Cleveland Clinic borrowed Sept. 11 via the corporate market at an interest rate of 4.86 percent for a century, data compiled by Bloomberg show.

While historically low yields are luring issuers, some investors are balking at longer debt.

BlackRock Inc., the world's largest asset manager, is shifting to 10- to 15-year bonds from longer maturities, Peter Hayes, the company's head of municipal debt, said in a Sept. 10 report. Fidelity Investments is also focusing on intermediate debt, said Kevin Ramundo, a money manager who helps oversee its $28.6 billion of state and local securities.

Matching Liabilities

Loews Corp. (L), the holding company run by New York's Tisch family, is still interested in 30-year debt, though not centuries, said Mark Muller, a money manager who helps oversee $13 billion of munis in New York. Demand from philanthropies and insurers looking for assets to match indefinite liabilities dwarfs the supply of 100-year bonds, which means more borrowers may emerge, he said.

"It has been more about supply in century bonds than it has been about demand — demand is always there," Muller said in an interview. "We will go through so many interest-rate cycles by the time these bonds ultimately mature" that investors will have the opportunity to buy higher-yielding debt in the future, he said.

Ohio State's 2011 centuries reflect the appetite. The debt, rated Aa1 by Moody's Investors Service, traded last week at a 4.54 percent yield, the lowest since May 2013, Bloomberg data show.

'Permanent Capital'

The Cleveland Clinic, which opened in 1921, sold $400 million of debt last week.

"We looked at it as an opportunity for the clinic to raise the closest thing to permanent capital that a not-for-profit organization can have," said Steven Glass, chief financial officer of the institution, the 12th-biggest Moody's-rated U.S. health-care system by revenue and the largest employer the city has ever had.

"There's a very unique group of organizations that could access the market to do 100-year bonds," he said. "The investors feel like this is an organization that, with all the changes in health care, is going to be one of those that's here to stay."

Buyers had a similar stance toward about the District of Columbia Water & Sewer Authority, which serves the White House. It issued $350 million of taxable 100-year debt in July, with proceeds going toward a $2.6 billion project to curb sewer overflows.

Cancer Center

Ohio State's sale, which will also include $150 million of variable-rate debt, will complete a capital plan that began in 2010, Papadakis said. The bonds will help fund a $1.1 billion medical-center expansion, he said. They will also finance other infrastructure projects for the school, which enrolls about 63,000 students.

Though munis and Treasuries have slumped the past two weeks, longer bonds have still outperformed their shorter-term counterparts.

Benchmark 30-year munis yield 3.15 percent, compared with 2.29 percent for 10-year maturities. The difference has shrunk from 1.3 percentage points to start the year. Longer-maturity bonds typically have higher yields to compensate for the added risk of the lengthier holding period.

Bonds maturing in longer than 22 years have earned the most in the $3.7 trillion municipal market this year. Their 12 percent gain compares with the broad market's 7 percent rally, Barclays Plc data show.

"This is a historically great opportunity to lock in low-yielding long-term debt," said Muller at Loews.

BLOOMBERG

By Brian Chappatta Sep 15, 2014 5:00 PM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Mark Schoifet

---

Mintz Levin: Court Rules on Applicability of Make-Whole Premiums Upon Debt Acceleration.

The linked Mintz Levin client advisory, which discusses a recent bankruptcy court ruling regarding the applicability of a make-whole premium upon a refinancing of corporate debt following such debt's automatic acceleration upon bankruptcy under the terms of the governing documents, may also be of interest to holders of municipal bonds with call protection and/or early redemption premiums.

In the context of make-whole premiums, court decisions suggest that the applicability of the premium upon a refinancing in bankruptcy will be governed by the wording of the debt documents, and that if an automatic acceleration is triggered by the documents and the documents do not expressly provide for a prepayment premium in such circumstances, no prepayment premium will be payable by the issuer.

Municipal bonds typically feature fixed percentage optional redemption premiums rather than make-whole premiums, but courts may also be inclined to apply to municipal bonds the principle that such early redemption premiums are inapplicable upon an acceleration absent express contract language applying the premium in that context (or, as some courts have suggested, absent evidence that the issuer deliberately defaulted for the purpose of circumventing the call protection provisions.)

Len Weiser-Varon | Mintz Levin

9/19/2014

House P3 Panel Calls for Supporting Greater Use of P3S.

The House Transportation and Infrastructure's special Panel on Public-Private Partnerships on Wednesday recommended improving public sector capacity to undertake P3s, lowering barriers the federal government to entering P3s agreements and ensuring transparency and accountability when the government and the private sector partner on infrastructure projects.

The panel's final report called for creating a Transportation Procurement Office in the Department of Transportation to implement P3 procurement best practices, including P3 model contracts, and continuing the Transportation Infrastructure Finance and Innovation Act (TIFIA) program.

"Billions of dollars of infrastructure needs in the U.S. are in search of funding, and well-executed public-private partnerships can enhance the delivery and management of infrastructure," Rep. John Duncan (R-Tenn), chairman of the P3 panel, said. "P3s cannot provide the sole solution to all of the Nation's infrastructure needs, but they can offer significant benefits, particularly for high-cost, technically complex projects that otherwise may risk dying on the vine."

Echoing Duncan's statement, Rep. Peter DeFazio (D-Ore.), told reporters the even under optimal conditions, only 10 to 12 percent of infrastructure would be funded through P3s.

"We are still going to need a very significant and robust federal investment to solve these problems," DeFazio said at a press conference.

In addition to proposals to streamline the P3 process for government, the report proposes improvements to traditional procurement processes.

Over the past six months, the panel held roundtables, hearings and meetings in an effort to understand the role P3s play in development and delivery of transportation and infrastructure projects. In March, NCPPP President Sandra Sullivan testified before the panel, discussing the importance of P3s in water infrastructure.

NCPPP
By Editor September 17, 2014

Social Impact Bonds are Going Mainstream: Forbes.

Now making waves in public finance circles are social impact bonds (SIBs). The bipartisan funding concept is a type of "Pay For Success" model where private investors invest capital and manage public projects, usually aimed at improving social outcomes for at-risk individuals, with the goal of reducing government spending in the long-term. Some social impact bonds seek to reduce the prison population through funding rehabilitation and employment programs for first-time offenders with the ultimate goal of reducing recidivism rates. Other SIBs seek to reduce the number of children in foster care. The catch is that private investors front all the costs and will be paid back a financial return by the government if and only if social outcomes are improved based on some standard measurement. The profit-motivating component comes from the fact that some of the savings from reduced costs for the government can be used to pay back the investor contingent upon their success. Now, Congress is considering the bipartisan Social Impact Bond Act, legislation that will enable the U.S. federal government to allocate $300 million to SIBs. A House Committee on Ways and Means hearing discussing the merits of social impact bonds led by the two co-sponsors of the bill, Rep. Todd Young (R-IN) and Rep. John Delaney (D-MD), was held last week.

Continue Reading.

Duane Morris: Has P3 Reached a Tipping Point in The United States?

Malcom Gladwell's 2000 best-seller The Tipping Point: How Little Things Can Make a Big Difference posits that most social shifts (or epidemics, as Gladwell refers to them in his book) share common characteristics, including what he refers to as (1) the law of the few, (2) the stickiness factor, and (3) the power of context. Gladwell asserts that a few influential innovators, whether purposefully or unintentionally, influence society to change, that the changing force has an "it" factor that captures our imaginations and that societal context can speed up change in a way that seems epidemic. These three factors come together and form a phenomenon Gladwell refers to as a Tipping Point, where an idea can go from small to big in a real hurry.

Though not stated with the exact paradigm used in Gladwell's book, this is essentially what Moody's Investors Services Managing Director Chee Mee Hu says is happening for Public Private Partnerships (P3s) in the United States. He states:

More US states and governments around the world are using P3s to develop and maintain public infrastructure . . . Two inter-related trends are at work that could cause P3 activity to expand: the need to upgrade, replace or build out essential infrastructure assets and the inability of governments to finance these current and future infrastructure investments entirely on their balance sheets.

A solution to an infrastructure problem is taking hold in this country, as a result of its adoption by influencers, and the timing and context are perfect for that idea to become really big. The Moody's press release is available here and refers to Moody's recently released "Global P3 Landscape" report.

P3s have long been touted as a solution to infrastructure funding shortfalls, and, slowly, this concept is taking root across the country. The Moody's article cites to a number of P3 transportation projects already underway, but the reality is that P3 is also being used for downtown city planning in San Antonio and even for scientific cancer research. Furthermore, P3s are also being considered for all manner of infrastructure projects, including schools, ports, tunnels, bridges, and water treatment plants, to name but a few.

Moody's states that P3 models have been steadily increasing over the last five years and that "given the sheer size of its infrastructure and growing urban population, the US has the potential of becoming the largest market for public-private partnerships (P3s) in the world."

Last Updated: September 12 2014
Article by Antony L Sanacory and William W. Fagan III
Duane Morris LLP

FT: Century Bond Surge Defies Rate Fears.

Investors are seizing the chance to lend money to US companies and municipalities for up to 100 years in exchange for a chance to capture higher yields for longer.

Sales of the so-called ultra long bonds, those maturing in 50 years or longer, have exploded this year despite expectations of higher US bond yields, which may hit long-dated corporate and municipal debt.

Cleveland Clinic, the Ohio-based medical and research centre giant, became on Thursday the first not-for-profit healthcare company to sell 100-year bonds.
Strong demand from institutional investors, such as large pension funds and insurers, has boosted total returns on the bonds with investors leaving aside concerns about duration – a measure of the sensitivity of bond prices to changes in interest rates – in their bond portfolios.

Longer dated bonds have higher duration, meaning they are more vulnerable to interest rate increases.

“It is a special market, for investors who are comfortable managing a higher exposure to duration risks in exchange to adding great names to their portfolios and the possibility of earning higher yields,” said Jay Sterns, director of public finance at Barclays.

Some large corporate borrowers, including Caterpillar and EDF, and not-for-profit organisations, such as the Massachusetts Institute of Technology, have tapped the ultra-long market this year.

Total sales of the securities are running at $14.3bn, a jump of almost 60 per cent from the same period in 2013, according to Dealogic.

Long-term corporate debt has generated a total return of 11.5 per cent so far in 2014 compared with a 3.6 per cent return on corporate bonds maturing in 10 years or less, according to Barclays.

The strong performance on long-term debt has been welcomed by pension funds and insurers, which have been traditionally the biggest buyers of this type of bond.
They use high-grade, longer-dated securities to match their underlying liabilities.

But a broader pool of buyers and borrowers has been increasingly attracted to the ultra-long corner of the market.

The Cleveland Clinic deal follows the sale of $350m worth of “century” bonds from the District of Columbia Water and Sewer Authority in July.

Cleveland Clinic completed the sale of $400m in securities maturing in 2114, with yields of about 4.85 per cent, compared with 3.27 per cent for the US 30-year note, according to people familiar with the sale.

Cleveland Clinic’s century bonds received an investment-grade rating of Aa2 from Fitch Ratings, and will account for about 12 per cent of the company’s total debt portfolio, according to Fitch Ratings.

Barclays and JPMorgan managed the offer.

Mr Sterns said there are at least another 15-20 tax-exempt healthcare companies with the right profile to sell century bonds.

“We saw the 100-year funding option as a very good opportunity for us given the combination of low borrowing costs and investor interest,” said Steve Glass, chief financial officer of Cleveland Clinic.

The Financial Times

September 11, 2014 6:20 pm

By Vivianne Rodrigues in New York

Municipal Market Advisors Municipal Issuers Brief - September 15, 2014.

Read the Brief.

Bank Buying Spree Undiminished by Liquidity Rules: Muni Credit.

Banks added to a record bet on the $3.7 trillion municipal market last quarter as an unprecedented rally overshadowed regulations that will remove an incentive for the companies to own the securities.

U.S. lenders boosted holdings of state and city debt by $4.7 billion from March through June to $430 billion, the most since Federal Reserve data begin in 1945. The purchases extended a more than four-year spree that swelled banks' ownership by $206 billion, exceeding all other types of investors, according to Fed data released yesterday.

The institutions' appetite helped propel the local-debt market to eight straight months of gains to start the year, the first time that has happened in Bank of America Merrill Lynch data going back to 1989. The banks are buying even as a pending rule change will exclude local debt from the easy-t--sell assets banks can hold to weather a credit crisis. Their demand is helping munis outpace corporate bonds and Treasuries.

"Munis are attractive," said Vikram Rai, a Citigroup Inc. municipal analyst in New York. "There's a global scarcity of high-quality, liquid assets."

Keeping Company

Banks aren't the only buyers this year. Individuals, who own at least 40 percent of the market as of June, have added $8.3 billion to muni mutual funds in 2014, Lipper US Fund Flows data show. Meanwhile, issuance is about 13 percent below last year's pace as the lingering strains of the recession that ended in 2009 leave officials wary of taking on new projects, data compiled by Bloomberg show.

Munis have earned about 8 percent this year, on pace for the biggest annual gain since 2011, according to Bank of America indexes. That compares with returns of 3 percent for Treasuries and 5.5 for corporate debt.

The rally has pushed muni borrowing costs toward generational lows. Benchmark 10-year munis yield about 2.28 percent. For buyers in the top federal income bracket, that's equivalent to a taxable rate of 3.8 percent. In comparison, similar-maturity Treasuries yield about 2.6 percent.

"Munis have been outperforming other asset classes," said Robert Donahue, a managing director at Concord, Massachusetts-based research firm Municipal Market Advisors. "Banks have really been buying for the yield."

Expanded Role

Since the credit crisis, banks have expanded their role in the municipal market as demand for other types of loans dimmed while the economy recovered.

They increased munis holdings every quarter since late 2009, even as the broader market began to shrink in 2011, Fed data show. By the end of June, they held 12 percent of the market, twice their share at the end of 2009.

State and local officials, including California Treasurer Bill Lockyer, have expressed concern that the new regulations will drive banks away from the market.

The rules, first released in 2013, were approved by the Fed and other regulators this month. While banks won't be able to use munis to satisfy the liquidity requirement, the Fed said it may tweak the rules to allow the most easily traded munis to be included.

Assets Aplenty

Most banks have enough assets on hand so that they don't need to use munis to meet the standards, which take effect starting in January, said Bank of America muni analyst Philip Fischer. The rules may cause banks to sell munis during times of financial stress, he said.

"We don't expect that to be a near-term effect, but it introduces one more risk to the market," said Fischer, who's based in New York.

Banks buy munis primarily for investment reasons, procuring money at short-term rates and plowing it into higher-yielding, long-term bonds, he said.

Munis maturing in 25 or more years are the biggest draw, said Citigroup's Rai.

As the market has rallied this year, long-dated securities have fared the best. Bonds maturing in more than 22 years have returned about 12 percent, according to Barclays Plc data. That compares with the 6.7 percent return on 10-year debt.

"We expect these buying patterns to continue," he said. "It's been a strong source of support."

BLOOMBERG

By William Selway Sep 19, 2014 9:31 AM PT

To contact the reporter on this story: William Selway in Washington at wselway@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Pete Young

---

WSJ MoneyBeat: Municipal-Bond Issuers Find It's Easy Being 'Green.'

Massachusetts, a pioneer in selling so-called green bonds for environmental projects, is going greener.

The state this week is selling $350 million of the bonds, more than triple the size of last year's sale, as more municipalities tap into investor demand for environmentally friendly investments.

Case in point: California is prepping its first green-bond sale ever and plans to start selling $200 million in the debt Friday. Earlier this year, the New York State Environmental Facilities Corp. and the District of Columbia Water and Sewer Authority sold green bonds, with the latter selling a bond that matures in a whopping 100 years.

Investors who buy green bonds are paid interest and principal from the same revenues as other municipal bonds. The difference is that municipalities pledge to use the proceeds of a green-bond sale for projects that are environmentally friendly.

Massachusetts will use this week's green bond to help pay for a marine terminal in New Bedford, Mass., that will be designed to support the construction of offshore wind projects. The state will also use proceeds for clean-water, energy-efficiency, river-revitalization and open-space-protection efforts, according to the prospectus.

As of late Wednesday morning, the state had received more than $250 million in orders for the green bonds from individual investors. A 10-year bond, rated double-A-plus, was offered to yield 2.45%. The sale is to be completed Thursday after orders from larger institutional investors.

“There are an increasing number of investors, both individual and institutional investors, who want legitimately green, energy-efficient projects in which they can invest,” said Massachusetts Treasurer Steven Grossman. “I would think it is overwhelmingly likely that we will do this again in the future and that it will be a regular part and fixture of our bond offerings.”

The growth in green bonds this year “is partially due to the success of the bonds that were issued last year,” said Kevin Lehman, a credit analyst at Breckinridge Capital Advisors, which oversees about $20 billion and has bought green municipal bonds in the past.

“We invest in projects that are essential to a community, and typically these environmentally related bonds are essential projects that support the community in critical ways, whether it’s through clean water or whatever it might be,” he said.

California didn’t indicate a specific project that would be funded with its green-bond proceeds but provided a list of similar categories to which the money could be allocated.

California has experience on the other side of green-bond transactions—on Wednesday, it announced it agreed to buy $250 million in two-year green bonds issued by the World Bank for the state’s pooled investment account. California has been buying World Bank green bonds since 2009.

“It’s a way to provide investors an opportunity to buy bonds that they know will be used exclusively to finance projects that strengthen and protect the environment,” said Tom Dresslar, a spokesman for California Treasurer Bill Lockyer. “We finally reached the point where we were comfortable going down this road.”

There are no immediate plans for a second green-bond sale, but Mr. Dresslar said, “we hope it becomes a permanent part of our bond-sale program.”

Not all investors are enthusiastic. Marilyn Cohen, president at Envision Capital Management in California, which oversees $320 million, said she wouldn’t be opposed to buying green bonds as long as they are backed by the state’s taxing authority, like other California state bonds. But she said she would skip the coming sale because her clients are already fully invested in California state debt.

The green-bond label is a marketing tool to “entice the retail public,” she said. “I, for one, find it a big yawn.”

THE WALL STREET JOURNAL

By MIKE CHERNEY
Sept. 17, 2014 7:01 p.m. ET

Write to Mike Cherney at mike.cherney@wsj.com

[CUSIP: Municipal Bond Issuance Indicator Showing Improvement.]

"Though we've seen some noteworthy declines in requests for new corporate bond issues in the US and international markets in August, it could be attributable to a seasonal blip," said Richard Peterson, Director, Global Markets Intelligence, S&P Capital IQ. "However, with major monetary policy decisions looming at the Fed and European Central Bank, we will have to watch the CUSIP indicator closely over the next several months for signs of a changing tide in new capital creation."

[Read Press Release.]

September 15, 2014

[MMA Municipal Issuer Brief - Sept. 8, 2014]

This week's [Municipal Market Advisors issuer brief] takes a look at which of the seven bigger budget states that have reported their annual earnings actually made their revenue projections for the 2014 fiscal year that ended on June 30. The report found that California, Massachusetts and Ohio reported actual revenues above their projections while New Jersey, Pennsylvania, Connecticut and Florida revenues came in below forecasts (even though these states still outperformed the previous fiscal year's actual performance). "The takeaway here," said MMA, "is that the estimates in these states were overly aggressive, possibly to use revenue to 'balance' the budget while spending more in the interim."

Whether a state makes its revenue target is important to investors and credit analysts. But it also sends a crucial signal to localities within a state. "Revenue performance can indicate whether shortfalls (or surpluses) are in the future, possibly meaning painful budget cuts and even rating downgrades," MMA said.

[Scranton Stalked by Bankruptcy Mulls Selling Sewers: Muni Credit.]

Scranton, with the weakest pension plan among Pennsylvania's cities, is trying to prop up its retirement funds to avoid becoming the first U.S. municipality since Detroit to file for bankruptcy.

The former manufacturing community will tax commuters starting next month and may sell its sewer system to buttress its retirement funds. The city has 23 cents for every dollar in retiree obligations, down from 47 cents in 2009, according to state data. Without a fix, Scranton may go bankrupt in less than five years, said Pennsylvania Auditor General Eugene DePasquale.

Cities and towns nationwide are coping with paying for pension benefits agreed to in more robust fiscal times. Pennsylvania ranks among the states of most concern since it has allowed municipalities to underfund mounting obligations, said Tamara Lowin, director of research at White Plains, New York-based Belle Haven Investments, which manages about $2 billion of municipal bonds.

"Without union cooperation, it would be incredibly difficult for them to resolve their liability problem outside of bankruptcy," she said.

National Deficit

Localities in Pennsylvania face at least $6.7 billion in unfunded pension liabilities, DePasquale said. The state, home to more than a quarter of U.S. public-employee plans, should consolidate systems and limit the local pension costs that it reimburses, he said.

Across the country, municipal officials have altered pensions, from Washington's repeal of some workers' cost-of-living adjustments, upheld by its Supreme Court this year, to Rhode Island's hike in retirement ages in 2011. States and local governments had about $1.4 trillion less than they needed as of the end of March to pay for promised benefits, according to the Federal Reserve Board.

Scranton, about 125 miles (201 kilometers) northwest of New York, is considering changes to its plans, said David Bulzoni, the business administrator.

"We would like to be in a position to try to solve as many problems that we can, with assistance from the commonwealth, without having to look at that option," he said of bankruptcy.

Distressed Program

The city has been in Pennsylvania's program for fiscally distressed municipalities, called Act 47, since 1992. At the time, it was racking up budget deficits and had lost 21 percent of its population over two decades, according to the state's Community and Economic Development Department.

Dwindling coal and railroad industries took a toll, said Jason Shrive, the city's lawyer. The community is still shrinking: its population fell 0.4 percent from 2010 to 2013, to about 76,000 residents, even as Pennsylvania's grew 0.6 percent, Census data show. About 21 percent of Scranton residents live in poverty, compared with 13 percent statewide.

The city, with an annual budget of about $130 million, has about $99 million of debt, financial filings show. None of the three biggest ratings companies grade the bonds.

Scranton general obligations maturing in September 2028 and insured by Ambac traded Sept. 5 at an average yield of 6 percent, or 3.5 percentage points above benchmark munis, data compiled by Bloomberg show.

Three Funds

The city runs three pension funds, one each for police officers, firefighters and non-uniformed personnel. The police and fire plans have fewer active employees than retirees, according to the auditor general's report. Combined, the funding status is 23 percent, weakest among Pennsylvania cities, data from the state's Public Employee Retirement Commission show.

The funds for fire personnel and municipal workers will run out of money in about three years and for the police, in about five, DePasquale's report said.

Scranton "will be facing bankruptcy within five years, potentially sooner without a fix to this," he said by telephone.

Municipal bankruptcies are rare, with 291 since 1980 and no filing by a community since Detroit's record case in July 2013, said James Spiotto, a bankruptcy specialist and managing director at Chicago's Chapman Strategic Advisors LLC, which advises on financial restructuring.

Wake Up

"Detroit has been a wake-up call for others to address their problems," he said. "Chapter 9 is a process, not a solution. It is time-consuming and uncertain, and you may wind up in a place where you may not want to be."

Scranton's pension costs are rising. The city's contribution next year will reach $15.8 million, from $3.4 million in 2008, data from the city and the auditor general show. Pension expenses will take up 16 percent of the budget in 2018, from 9 percent in 2006, according to a July presentation by Hackensack, New Jersey-based financial consultant HJA Strategies LLC.

The seat of Lackawanna County, Scranton passed a 0.75 percent income tax on nonresident commuters effective Oct. 1. The measure would generate at least $5 million annually, based on county data on tax collections, and the funds would go toward pensions, Bulzoni said.

Besides the local and federal governments, top employers include health-care centers, a bond document shows. Opponents have sued to prevent the levy, which they consider illegal.

Sewer Sale

Another option is to sell the sewer authority, which has started a review of the proposal, Bulzoni said. In addition, municipal officials this month met with union representatives to discuss contract features that are depleting pension assets, Bulzoni said. He declined to elaborate because he said some solutions will involve bargaining.

"There has to be some collective agreement to help shore up the plan's solvency," he said.

John J. Judge IV, president of the International Association of Fire Fighters Local 60, said he's optimistic officials will solve the fiscal crisis.

"It's going to take a little bit of time to turn it around," Judge said.

By Romy Varghese Sep 14, 2014 5:00 PM PT

To contact the reporter on this story: Romy Varghese in Philadelphia at rvarghese8@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Stacie Sherman

---

Chicago Water Bonds Seen Shielded From Pension Woes: Muni Credit.

Chicago, bearing the biggest pension burden among the nation's most-indebted localities, is selling water bonds for the first time since 2012. Investors say the deal's strengths outweigh the city's fiscal woes.

Tomorrow's planned sale of about $372 million of debt will pay for work on pumping stations and the replacement of water mains, some of which are more than a century old, according to bond documents and the city. Mayor Rahm Emanuel in 2011 set in motion an almost doubling of water and sewer rates over four years. The move has bolstered the system's finances, earning the debt a AA- grade, Standard & Poor's fourth-highest level.

While Emanuel pushed through higher rates, he has failed to contain the swelling pension costs that led Moody's Investors Service to cut Chicago's general-obligation rating to the lowest among the 90 most-populous U.S. cities, excluding Detroit. Paul Mansour of Conning and Patrick Morrissey of

Great Lakes Advisors LLC are considering buying the water bonds, in part with the expectation that the association with Chicago will boost yields on an otherwise healthy issuer.

“The water enterprise bonds are among the best that Chicago can offer,” said Richard Ciccarone, the Chicago-based chief executive officer of Merritt Research Services LLC, which analyzes municipal finance. “Even though Chicago has been in the news and has some fiscal challenges, the enterprise itself has been well-supported.”

Chicago faced heightened scrutiny in the $3.7 trillion municipal market after Moody’s in July 2013 lowered the city’s grade three levels the same week that Detroit filed for bankruptcy. The New York-based company dropped Chicago again in March, to Baa1, three steps above junk.

The park district, board of education and transit authority also had their ratings cut by Moody’s. The same goes for the water and sewer system: its A3 mark for second-lien bonds, the fourth-lowest investment grade, is down three levels from 14 months ago.

Moody’s may be too punitive, said Morrissey, who helps oversee $3.8 billion of fixed income at Great Lakes Advisors in Chicago. S&P ranks the second-lien water and sewer bonds three levels higher than Moody’s.

Payoff Time

S&P’s rating shows that “Chicago’s efforts are paying off with respect to increased service coverage and better financial oversight of our utilities,” Emanuel, a 54-year-old Democrat who is up for re-election next year, said in a Sept. 2 statement. S&P also rates the city’s general obligations three steps higher than Moody’s.

The water system’s finances have improved. Revenue is projected to double by 2016 from 2009 after the rate increases, while cash reserves are expected to hold at three months of operating expenses through fiscal 2016, bond documents show.

While Chicago’s rates rose 25 percent in 2012, with planned increases of 15 percent in each of the following three years, residents in New York, Los Angeles and San Francisco face higher charges, bond documents show. A family’s cost per 7,500 gallons of water in Chicago was below $30 in 2013, compared with more than $50 in San Francisco, according to the documents.

Chicago’s system, whose source is Lake Michigan, supplies and treats water for about 5.4 million people in Chicago and its environs. Suburban customers made up about 47 percent of net sales in 2013, bond documents show.

880 Miles

The 10-year project that Emanuel introduced in 2011 will improve pumping stations, replace 880 miles (1,416 kilometers) of water main and install 204,000 meters.

This is the first sale of water debt for the city since May 2012, according to data compiled by Bloomberg. The bonds are federally tax-exempt though subject to state levies.

Among the most-traded Chicago water and sewer bonds in the past week have been wastewater securities callable in January 2017, Bloomberg data show. A customer bought the debt Sept. 2 with a 1.57 percent yield, or about 1.2 percentage points above benchmark debt, the narrowest gap since July.

Chicago also plans to sell $301 million of second-lien wastewater bonds next week to fund sewer improvements, according to deal documents and Bloomberg data.

While the water system's customer base and the city's control over rates buoy the bonds, investors have to consider Chicago's risk of fiscal distress, said Mansour, head of muni research in Hartford, Connecticut, at Conning, which oversees about $11 billion of local debt.

Association Eyed

"There has to be some premium associated with this credit because of the outside chance the city of Chicago's ratings could fall again, and this credit could go along with it," he said by telephone.

Chicago's pension liabilities represented 678 percent of revenue in fiscal 2011, according to a Moody's study released in September 2013. The city found a partial solution in June to address the $19.2 billion shortfall across its four retirement funds. Illinois lawmakers restructured two of the systems, which had a combined $9.4 billion in unfunded liabilities for about 60,000 municipal workers and retirees.

The water system pays into the pension fix, showing it's not immune to the city's financial pressures. The measures increase the system's yearly pension contributions, which were $13 million in fiscal 2013, by an average of 25 percent a year until fiscal 2019, bond documents show. The additional revenue from rate boosts is projected to "more than offset increases in retirement costs," the documents say.

"The water and wastewater credits are largely insulated from the city's general finances," Libby Langsdorf, a city spokeswoman, said in an e-mail.

Any yield premium on the water bonds may make the debt more attractive, said Ciccarone.

"The most important takeaway is they're revenue-based," Morrissey of Great Lakes Advisors said of the bonds. "There's so much less risk of people not paying their water bills here, and the revenue increases have already been put in place."

By Elizabeth Campbell and Brian Chappatta Sep 8, 2014 5:00 PM PT

To contact the reporters on this story: Elizabeth Campbell in Chicago at ecampbell14@bloomberg.net; Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Pete Young

---

Send Letters to Congress Supporting the Modernizing American Manufacturing Bonds Act.

Call to Action:

CDFA has begun a targeted letter-writing campaign. We ask that industry stakeholders send letters to the House and Senate members to support CDFA's Modernizing American Manufacturing Bonds Act and the suggested reforms to modernize and revolutionize Qualified Small Issue Manufacturing Bonds. To make this process easier, we have created sample letters for your use.

Download the sample letters provided below and modify them to fit your letterhead. Email and fax letters to your representatives ASAP. Please also copy CDFA on any correspondence, and we will follow-up with the appropriate office holder.

The following letters should be used to help CDFA's legislative efforts:

Sample House Letter

When sending letters please follow these instructions:

- Use this sample text to craft your letter.
- Letters should be tailored to reflect your state/city and placed on your organization's letterhead.
- For full Congressional office contact information go to www.house.gov or www.senate.gov.
- Letters should be faxed to your Congressional first.
- Mail letters AFTER you fax them. They will take several days to reach the Capitol office.
- For assistance with crating your letters, do not hesitate to contact CDFA.
- Send a copy of your letter to CDFA @ kwhite@cdfa.net.
- Be sure to remove this header from your letters.

Feds Step Up Quest for Private Infrastructure Financing.

The Obama administration is pushing ahead with its campaign to draw more private dollars to narrow the huge U.S. infrastructure-finance gap, announcing on Sept. 9 a flurry of project-funding actions.

Officials made the announcements at a Washington, D.C., "summit," at which Cabinet secretaries heard ideas from public and private officials on further ways to spark increased private investment in highways, bridges and other infrastructure.

Transportation Secretary Anthony Foxx told attendees at the meeting that his department had approved a $950-million Transportation Infrastructure Finance and Innovation Act loan for the Interstate 4 project in Orlando, Fla. The loan is the largest to a public-private-partnership project in the TIFIA program's 16-year-history.

Foxx also said DOT had approved a $1.2-billion allocation of federal private-activity bonds to the Pennsylvania Dept. of Transportation for its ambitious program to replace 600 bridges in 42 months, using a single public-private partnership (P3).

Moreover, he said DOT is providing $20 million for a new transit-oriented-development pilot program.

Other agencies are taking infrastructure-related action, too. Treasury Secretary Jacob Lew said his department will commission an independent report to identify planned transportation and water infrastructure projects that are judged to have the greatest economic impact.

The White House said that the Agriculture Dept. had approved $518 million in loans for rural electricity projects.

In the nongovernment sector, the California State Teachers' Retirement System is forming a consortium with other pension funds to invest in U.S. infrastructure, Christopher Ailman, chief investment officer, said at the summit, which was held at Treasury’s headquarters.

The White House also said the Ford and Rockefeller foundations are teaming up on a new effort to stimulate innovation in infrastructure projects.

As part of President Obama’s “Build America Investment Initiative,” announced on July 17, he directed Lew and Foxx to lead an interagency infrastructure-finance working group to identify ways to overcome hurdles to private financing and to speed projects to completion.

They are to produce recommendations by Nov. 14. The summit, part of the two secretaries’ search for suggestions, drew more than 100 top infrastructure-finance officials from the public and private sectors.

Much of the discussion at the public portion of the meeting centered on the transportation sector, which has had more P3 and related types of private participation than other markets.

Infrastructure’s financial needs are immense. Lew said the U.S. faces a $1-trillion infrastructure-funding gap by 2020, counting all major sectors.

Commerce Secretary Penny Pritzker, who also addressed the gathering, said the stock of all public infrastructure was valued at nearly $10.8 trillion in 2012, according to Commerce’s Bureau of Economic Analysis. It will take $360 billion per year just to maintain that infrastructure’s current condition, she added.

Lew said that “while direct federal spending on infrastructure is indispensible, we recognize the reality that budget limitations at every level of government make it all the more important to come up with fresh, innovative ways to unlock capital and get more projects under way.”

Summit participants gave the meeting positive reviews. Ananth Prasad, secretary of the Florida DOT—a leader in transportation P3s—told ENR that the summit was helpful in hearing what private investors are looking for from owners. Those factors, hes said, include creating a marketplace for P3-type projects and agreeing on “some sort of standardization“ in that sector.

Private investors don’t view all projects as good prospects, Prasad notes. “So project selection is key, engaging the industry…and early, and trying to have a predictability is the bottom line of success,” he says.

Some panel members at the conference outlined projects on which they had worked. Jim Tymon, American Association of State Highway and Transportation Officials director of management and program finance, says it was beneficial to hear about individual projects that went well. But moving forward, he says, “Let’s find ways to take those successes and replicate them nationwide.”

Jane Garvey, North American fund chairman of Meridiam, New York City, says that the meeting elicited “some very concrete suggestions, specific ideas.”

Garvey, former chief of the Federal Aviation Administration and acting head of the Federal Highway Administration, adds that the next step is “translating that into action items…many of which can be acted on administratively,” rather than through a probably lengthy legislative process.

Former U.S. DOT Secretary Rodney Slater, now a partner with law firm Squire Patton Boggs LLP, says that after the meeting, “I think that you’re probably going to see something happen on the private side, where they say, ‘Look, with all this effort on the public side, what can we do to match that energy?’”

Tyler Duvall, a principal in McKinsey & Co.'s Washington office, says he thinks the Lew-Foxx report will include recommendations on project prioritization and projects' pre-development phases.

Duvall, a former top U.S. DOT policy official, sees the main challenges for innovative financing center on management, process, and politics.

"I don't think we need 50 new financing tools," he adds. "I think we've got a good set of tools today. And we've got a lot of people who want to invest in this country."

ENGINEERING NEWS-RECORD

09/09/2014

By Tom Ichniowski

Moody's Predicts Huge Potential for Public-Private Partnerships.

Public-private partnerships are still relatively new for most U.S. states, but analysts anticipate they will become more common.

The United States could soon become the biggest market for public-private partnerships in the world, analysts from Moody's Investors Service said in a recent analysis of trends around the globe.

Thirty-three states now permit the partnerships for transportation projects, the credit rating agency noted, and many of those states adopted those laws within the last five years.

The way those partnerships are structured is also shifting. Many high-profile partnerships, such as the Indiana Toll Road, allow investors to make money based on the how well their asset performs. If a lot of people use a toll road, the investors make a handsome profit. But if traffic doesn't meet expectations, the investors could lose money instead.

Increasingly, though, U.S. governments are using an arrangement that is more common in Britain and Canada, where P3s are more common than in the U.S. Under the arrangement, governments regularly pay operators fees, called availability payments. That makes the arrangement less risky for investors but more risky for the government.

Nine deals in the U.S. using that arrangement have been inked. Three of them — the Long Beach courthouse in California, Miami's port tunnel and the I-595 managed lanes in south Florida — are operational. Another nine projects are expected to close in the next 18 months, according to Moody's.

Moody's analysts predicted that public-private partnerships would become more common for "social infrastructure," like schools and courthouses and, eventually for water-related projects. The ratings agency also noted that private investors are developing more expertise on public-private partnerships, which they use when interacting with state finance and transportation agencies.

GOVERNING.COM

BY DANIEL C. VOCK | SEPTEMBER 9, 2014

dvock@governing.com | https://twitter.com/danvock

A Better Way to Manage Government's Underutilized Property.

A startup emerging from academia wants to help cities get more value from publicly owned land.

Government owns 10 to 30 percent of the footprint of most cities, and the public sector is the nation's largest property owner. But property management is hardly a core function of government, so it's not surprising that many jurisdictions don't even have an accurate inventory of their own property. The data is often scattered across the various agencies in charge of different parcels.

Much public land is underutilized and expensive for taxpayers. The Office of Management and Budget estimates, for example, that it costs about $1.7 billion per year to maintain and secure underutilized federal properties. For municipal governments, there's also foregone property tax revenue and wasted opportunities to use the land to support local economic development.

A Boston-based start-up is looking to change all that. OpportunitySpace has its roots in the master's thesis of two Harvard Kennedy School students. It is a data hub and information platform that offers both municipalities and citizens consolidated, standardized data on government-owned land. Parcels are mapped geographically. By clicking on one, users can learn its square footage and assessed value.

The company has completed a pilot project with four Rhode Island municipalities including Providence, where the city's 1,363 publicly owned parcels are now posted online. OpportunitySpace is also operating in Louisville, Ky.

In addition to cutting municipal costs and boosting local tax revenues, the company hopes to increase transparency and the amount of creativity that surrounds development issues. In most cases, a sign in the ground is the only way to know a city is looking to sell a piece of property. At best, the property might be posted somewhere deep within a municipal website. OpportunitySpace hopes to make the information available to those who don't know their way around city hall or tax-assessor databases–to "democratize the sale of government-owned property," in the words of co-founder Cristina Garamendia.

As the fledgling company nears the end of its incubation period at the Harvard Innovation Lab, it expects to begin charging municipal clients a manageable subscription fee. The plan is for more of its revenue to be generated by selling sophisticated information to the private sector.

OpportunitySpace is working on adding information to its database, such as how to connect with experts and gain a better understanding of potential funding sources and redevelopment incentives. It also is adding zoning maps and information about where public investments, subsidies and tax abatements are focused.

OpportunitySpace has received a couple of boosts recently. Last month it was the subject of a New York Times article. This month it is one of the ideas recognized in the annual Better Government Competition sponsored by the Pioneer Institute, a Boston-based public-policy think tank. (I am affiliated with Pioneer as a senior fellow but was not involved with the competition).

It grabs people's attention when they can pay a highway toll electronically without slowing down. But technology is also enhancing government operations in ways that are less visible, though just as important. If it succeeds, OpportunitySpace will be a prime example of that, helping reduce municipal costs, hike revenues and broaden the marketplace of development ideas.

GOVERNING.COM

BY CHARLES CHIEPPO | SEPTEMBER 11, 2014

Charlie_Chieppo@hks.harvard.edu

Pensions' Unfunded Liabilities Still Going Up.

A new survey finds that pension funding levels across all states and major cities inched downward in 2013 and that cities are bearing a greater burden in their budgets than states.

A new survey has found that pensions' unfunded liabilities across all states and major cities inched up in 2013 and that cities are bearing a greater financial burden than states.

State pensions averaged a funded level of 73.1 percent in 2013, down from 73.5 percent in 2012, a Loop Capital Markets report released this week found. In cities, that ratio of the value of money in the pension fund compared to the cost of benefits already promised to retirees was 65.3 percent, down from 65.6 percent in 2012. (Actuaries tend to rate anything above 80 percent funded as an acceptable level.)

Additionally, cities face about three times the pension burden in their budgets that states do, Managing Director Chris Meir said during a conference call with investors Wednesday. On average, annual pension payments make up 4 percent of state budgets and 12 percent of city budgets, the report found. The budget strain doesn't correlate with how well a pension is funded. Cities like Philadelphia, Jacksonville and Phoenix all spend more than 20 percent of their budgets on pensions while Memphis and Little Rock spend 3 percent or less. All five of those cities have plans that are less than 75 percent funded.

Meir cautioned that a plan can appear healthy on paper but still be in trouble. For example, before filing for bankruptcy, Detroit had pension funds that were 91 percent funded and its pension payments accounted for 7 percent of the city budget. But Detroit had also assumed huge debt in 2006 to sell bonds that went directly into the city's pensions as a way to eliminate its then-unfunded liability. In essence, the city transferred its debt from one part of its books to another.

"Management skill and a culture of debt avoidance also very important factors," Meir said.

On the state level, funded ratios for 19 states improved in fiscal 2013, up from five states in 2012 and 14 states in 2011. Those that showed the biggest improvement (at least a 7 percentage point jump in funded levels) were Montana, Oregon, South Dakota and Ohio. The report found some similar attributes between these and other states that showed bigger improvements last year, including having a generally smaller population or one with lower union concentration (Ohio is an exception). "Right-to-work" states, in particular, tend to avoid such pension problems.

The report found fewer similar attributes between the 26 states that saw their funded levels decrease in 2013. But Meir said there are still some generalities among the states that saw the biggest declines. New Jersey pensions declined the most in 2013, dropping 7 percentage points in the average funded level. The next-biggest drops were in Massachusetts, New York and Virginia, which all dropped by 5 percentage points. Except for New York, states with funded ratios that have deteriorated the most in fiscal 2013 were weak pension performing states to begin with. And, the report noted, these are mostly "older" states in the Northeast and mid-Atlantic. More established states tend to have older — and therefore more expensive to maintain — infrastructure, which adds to their burden.

The conference call ended on an optimistic note. Meir noted that pension reforms have helped eat away at unfunded liabilities in many states and localities, albeit slowly. Thanks to each state's particular legal and economic structure, he said, the reform process has been a "state-by-state skirmish," thus dragging out the process.

"Therefore, we do not believe is a systemic problem," he said. "It is a state-by-state problem with a state-by-state solution."

GOVERNING.COM

BY LIZ FARMER | SEPTEMBER 12, 2014

lfarmer@governing.com | @LizFarmerTweets

Puerto Rico Utility Bond Agreement Limits Disclosure, MMA Says.

An agreement between Puerto Rico's junk-rated power utility and investors holding the bulk of its debt gives the agency time to mend its finances. It also offers some bondholders non-public information, says Municipal Market Advisors' Bob Donahue.

The Puerto Rico Electric Power Authority, called Prepa, the main supplier of electricity on the island, last month entered into an agreement with investors who collectively hold more than 60 percent of the utility's $8.3 billion of debt. For signing on to the contract, those bondholders will receive monthly cash statements and financing plans, according to the document for the deal, known as a forbearance agreement.

Such an arrangement is typical in the $3.7 trillion municipal-bond market, yet the amount of Prepa's obligations makes the situation unique, said Donahue, managing director at Concord, Massachusetts-based MMA. If the utility restructures its debt, it would be the biggest ever in the municipal market.

"The many disclosures that they will receive, that will create a real asymmetry in the market between those in the agreement and those outside," he said.

Lawmakers in June approved a law that would allow certain public corporations, including Prepa, to ask bondholders to take a loss. The commonwealth and its agencies have $73 billion of debt. The island's economy has struggled to expand since 2006, fueling speculation that Puerto Rico will be unable to repay all of its obligations on time and in full.

Restructuring Chief

Prepa last week picked Lisa Donahue, managing director at New York-based turnaround firm AlixPartners LLP, as chief restructuring officer to cut expenses and improve its finances. As part of its agreement with creditors, Prepa must release a five-year business strategy by Dec. 15 and create a debt-restructuring plan by March 2.

Members of the forbearance group can sell only to other bondholders in the group or to investors who agree to join it, according to the agreement.

Being privy to detail on Prepa's finances gives investors insight into other Puerto Rico credits, said Daniel Solender, who helps manage $15.5 billion of munis at Lord Abbett & Co. in Jersey City, New Jersey.

"It makes it a strange way to approach it, given how many different types of bonds are outstanding," Solender said. "If you have privileged information on Prepa, it affects the trading of all Puerto Rico bonds."

Prepa Rally

Lord Abbett held Prepa debt as of July 31, Solender said. He declined to say if the firm is part of the forbearance group.

Prepa has rallied since Donahue's appointment. The bonds are gaining in part because the universe of investors who can trade the securities has become limited by the agreement, MMA's Donahue said.

Prepa bonds maturing in July 2040 traded yesterday at an average price of 57.03 cents on the dollar, the highest since June 18, data compiled by Bloomberg show.

With Prepa's debt load and its financial challenges, the utility should disclose information to all investors at the same time through the Electronic Municipal Market Access website, known as EMMA, MMA's Donahue said.

"Given the high stakes and the difficulty that Prepa's facing, transparency would be the best antidote," he said.

David Millar, a New York-based spokesman for Puerto Rico's Government Development Bank, which handles commonwealth debt sales, didn't immediately respond to an e-mail and phone message. Abimael Lisboa Felix, a spokesman for Prepa in San Juan, didn't immediately respond to an e-mail and phone message.

By Michelle Kaske Sep 12, 2014 10:39 AM PT

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Mark Schoifet

---

Chicago at Brink of Swaps Fee as Bond Ratings Fall: Muni Credit.

Chicago's deteriorating credit quality has pushed taxpayers to the brink of paying almost $400 million to Wall Street banks on derivatives contracts that are backfiring.

The city and Chicago Public Schools, both at risk of rating reductions as pension obligations mount, agreed to interest-rate swaps with companies including Bank of America Corp., Goldman Sachs Group Inc. (GS) and Loop Capital Markets LLC last decade as part of debt sales. The accords were designed to cap expenses in case interest rates rose. The deals went awry as the Federal Reserve cut borrowing costs during the recession.

The issuers' combined bill to exit the deals has reached about $400 million, almost two-thirds more than the metropolis spent on streets and sanitation in 2013. The contracts on the derivatives stipulate that the banks can demand payment when the issuers' credit rating falls to a specified level. For the city, that trigger is one level away on most contracts after Moody's Investors Service cut it to three steps above junk.

"These governments are in a precarious position," said Laurence Msall, president of the Civic Federation, a Chicago watchdog on government finance. "Hundreds of millions of dollars are at stake."

Derivatives Trail

States and cities in the $3.7 trillion municipal market have paid at least $5 billion to banks to end interest-rate swaps, data compiled by Bloomberg show. The contracts contributed to the bankruptcies of Detroit and Jefferson County, Alabama.

In Chicago this week, Alderman Roderick Sawyer introduced a resolution in the city council calling for Mayor Rahm Emanuel to file an arbitration claim with the Financial Industry Regulatory Authority to recover payments the city and school district have made on swaps. That could generate more than $600 million and eliminate the need for termination payments, said Jackson Potter, an official with the Chicago Teachers Union.

"The mayor has made a commitment that the city will not enter into any new debt swaps of this kind and has enacted measures to modify and reduce risk to protect the taxpayers of Chicago," Carl Gutierrez, spokesman for the city's budget office, said in an e-mailed statement.

"We monitor our swap liability carefully and are in continuing conversations with our swap counterparties to manage the risks of our derivative portfolio," Bill McCaffrey, a schools spokesman, said via e-mail.

March Cut

The city had its general-obligation rating lowered to Baa1 in March by Moody's, which cited "massive" pension liabilities. The company also assigned a negative outlook, meaning more cuts are possible. A credit grade one level lower could trigger swaps termination fees of about $173 million, according to documents for a March bond sale.

The school system, the nation's third-largest, has more breathing room. It needs two rating companies to reach a predetermined rating level for a possible payment of about $224 million. It's Moody's rating is two levels from that point.

The potential payments increase pressure on state lawmakers, Governor Pat Quinn and Emanuel to reduce pension obligations, said Richard Ciccarone, Chicago-based president of Merritt Research Services. As the city and school system use reserves to balance budgets, they may have to look for new tax revenue, he said.

"There's not a lot of room for comfort at the schools or the city," Ciccarone said. "The parties need to work together to resolve a very pressing issue. Politics will just make it more difficult."

Illinois Bill

Quinn, a Democrat seeking re-election this year, signed a bill in June that partially addresses Chicago's $19.2 billion pension shortfall. The law, which cuts benefits and makes employees pay more for retirement, restructures two of the city’s plans, for about 60,000 municipal workers and retirees. The law doesn’t affect the police or firefighter obligations or lower retirement costs for the schools.

While those changes haven’t faced legal challenges, a state judge halted the implementation in May of an overhaul of the state retirement system after unions questioned its constitutionality.

‘Political Mess’

The political calendar may complicate matters.

Emanuel, a first-term Democrat, faces a potential challenge in February elections from Karen Lewis, president of the teachers union. Emanuel closed 49 underperforming elementary schools last year, hurting his approval rating, according to a Chicago Tribune poll released last month. That signals the difficulty he may face in addressing the district’s budget and pension issues.

Duane McAllister, who helps oversee about $5 billion of munis at BMO Asset Management Corp. in Milwaukee, said the pressures are keeping his company from buying.

“Chicago is sort of still mired in the political mess that seems to be Illinois politics,” said McAllister.

Some city debt is gaining in the face of the stress. Bonds maturing in January 2040 traded yesterday at an average yield of 4.72 percent, compared with an average of about 5 percent since March, according to data compiled by Bloomberg. Yesterday’s yield was about 2.6 percentage points above benchmark debt.

Moody’s in August warned of the “narrow distance to rating triggers” for the school system’s swaps. The district has 10 fixed-rate swaps with potential triggers if two of the three biggest rating companies cut the debt to the equivalent of Baa3, which is one step above junk, or lower.

Triggers Below

Moody’s grades it Baa1, two levels above the trigger. Fitch Ratings is at A-, three levels above the trigger, and Standard & Poor’s is at A+, which is five levels above. Moody’s and Fitch both have negative outlooks.

“There will be formidable pressure going forward,” said Mark Lazarus, a Moody’s analyst in Chicago. “It’s something you factor into future ratings.”

Hitting the trigger levels wouldn’t automatically mean the city or school district would have to pay to end the swaps; the banks would have the option to force payment. The companies could also take steps such as having the issuers put up collateral to secure the payments, as banks did to Detroit with taxes on its casinos.

Goldman Sachs declined to comment on the contracts, said Michael DuVally, a spokesman in New York. William Halldin at Charlotte-based Bank of America also declined to comment. James Reynolds, chief executive officer at Chicago-based Loop, didn’t respond to e-mails and a phone call seeking comment.

Reserve Stash

For Chicago, a termination payment would be manageable, said Ty Schoback, a senior analyst in Minneapolis at Columbia Management Advisors, which oversees $30 billion of munis.

“Chicago has got quite a bit of reserves stashed away,” Schoback said.

The city has reserves of about $625 million from leasing a tollway and parking system, according to a February S&P report.

Chicago’s payments for pensions are set to reach $1.1 billion in 2015 from about $478 million in 2014, according to financial documents.

The “aggregate amounts are not catastrophic,” said Arlene Bohner, a senior director at Fitch. Though “it is of concern given the other spending pressures they’re under.”

School Burden

For the school system, a termination payment would be “far more burdensome,” Schoback said.

The district, with about 400,000 students, has tapped reserves to balance its budget as pension costs rose. Swaps payments of $224 million would exceed the $216 million it has in debt-service reserves, according to Moody’s. The system is using about $862 million of budgetary reserves in its fiscal 2015 budget, leaving it with about $300 million, projections show.

Its pension contributions in fiscal 2014 and 2015 tally more than $600 million each year, up from about $200 million the previous three years, according to budget documents.

The city has modified some swaps, according to Bohner and its 2013 financial report, released in June. In March, it reduced the rating at which two of its 11 general-obligation swaps could be triggered, by one level to Baa3, according to the disclosure statement.

The efforts are a “work in progress,” said Fitch’s Bohner. “It’s definitely on their radar screen.”

By Darrell Preston and Elizabeth Campbell

Sep 11, 2014 5:00 PM PT

To contact the reporters on this story: Darrell Preston in Dallas at dpreston@bloomberg.net; Elizabeth Campbell in Chicago at ecampbell14@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Mark Schoifet

---

Reinventing Democracy through Participatory Budgeting.

For all the hype surrounding democracy as a concept, in practice it has fallen short of expectations. Americans are proud of the strength and resilience of their democratic institutions, and yet they are deeply distrustful of their elected officials and turning out to vote at ever lower rates. But the lofty goal of reinventing democracy appears infinitely more achievable when we have a mechanism for doing so. Participatory budgeting is coming to the fore as one of the most promising ways to change the relationship between citizens and government, as part of a wave of new democratic innovations.

Participatory budgeting offers a fundamentally different interpretation of democracy than what we have become accustomed to. What if instead of voting to give officials the right to make decisions on our behalf, there were forums that put decision-making authority directly into the hands of citizens?

Participatory budgeting, or PB, is a process that allows ordinary people to decide how part of a public budget should be spent.

A PB process begins with community meetings where residents are invited to come together and share their ideas. Next, volunteers take on the task of refining those ideas to develop project proposals. Finally, residents vote for the projects that they most wish to see funded. The results of the vote are binding, making PB a significant departure from forums that involve consultation but not action.

The Participatory Budgeting Project (PBP) has supported processes that have allocated over $45 million from public purses across the U.S. Those funds have brought to life more than 250 individual projects, designed by residents and chosen by over 50,000 voters.

Born in the Brazilian city of Porto Alegre in 1989, PB is now practiced in over 1500 cities around the world, and in over 40 communities across the US. In Chicago, where the US experience of PB began in 2009, more than 250,000 residents now have the opportunity to decide the allocation of $5 million.

In New York City, PB started in 2011 with the discretionary capital works budgets of four inspired city council members. It has since grown to include nearly half of the city's council districts. A city-wide youth PB process has been launched in Boston, giving young Bostonians aged 12–25 the opportunity to decide how to spend $1 million.

But PB is more than raw numbers: it matters who participates. Partnerships with local community organizations and targeted outreach have been crucial to ensuring that PB does not merely attract the "usual suspects" – residents who are white, middle to upper class, and highly educated. Instead, PB aims to give real decision-making power to all members of the community.

Furthermore, the process itself is as meaningful as the outcomes it generates. PB provides neighbours with the opportunity to learn from one another. It ignites discussions around whose interests are being served, and whose aren't. It provides a platform for residents to develop leadership skills that can be taken and applied in new contexts. Research in the U.S. to date suggests that these experience have powerful impacts on many PB participants, including those who don't typically get involved in political processes.

PB processes are growing across the U.S. Since we first worked with Chicago Alderman Joe Moore in Chicago in 2009, we have partnered with dozens of other elected officials to launch PB in their community. Last fall, the White House began promoting PB as a best practice of civic engagement, and we have worked with the U.S. Department of Housing and Urban Development to share PB resource on their website.

At the Participatory Budgeting Project, we are proud to continue to partner with national and local organizations to develop new tools, launch new PB processes, and improve existing PB processes, because we believe that transparent and engaged democracy makes our communities stronger. Join us in Austin to learn how to bring this exciting innovation in democracy to your communities, to engage constituents in making real decisions about real money.

SEPTEMBER 8, 2014
By Josh Lerner and Madeleine Pape

Josh Lerner will serve as a presenter and facilitator for the interactive NLC University Seminar, "Participatory Budgeting – How to Build Deep Community Engagement in Real Budget Decisions

(201)” at the Congress of Cities and Exposition on November 19th in Austin, Texas.

NYT: Detroit’s Bankruptcy Deal Hinges on 2 Banks.

The future of Detroit’s pensioners may depend on an insurer’s resolution of a dispute with Bank of America and UBS.

Syncora Guarantee, Detroit’s most vociferous adversary in bankruptcy, is close to a breakthrough settlement with the city, but before it can close the deal it must resolve a related dispute with two big banks, Bank of America and UBS.

The bankruptcy judge, Steven Rhodes, has adjourned a trial in the case until Monday. If Syncora cannot reach an agreement with the banks by then, it will face a breakdown of its whole deal with Detroit, which would give it a stake in vehicle tolls from the tunnel that runs between Detroit and Windsor, Ontario, as well as some nearby land.

Syncora’s dispute with the banks goes back to a $1.4 billion borrowing by Detroit in 2005. The city was already in dire financial straits and did not have enough to make its required pension contributions. After city unions sued, Detroit decided to borrow the money, and UBS and a precursor to Bank of America underwrote the deal. Syncora insured it along with another bond insurer, the Financial Guaranty Insurance Company.

The $1.4 billion did not solve Detroit’s problems, though — it merely bought the city some time and labor peace. Ultimately, it increased the amount of debt Detroit now has to deal with in its historic Chapter 9 bankruptcy case. In the bankruptcy framework, the borrowing has turned out to be so messy and intractable for the municipal bond market that it almost seems to stand as an example of why it is a bad idea to fund public pensions with borrowed money. Such deals continue to be done in many places, however.

In bankruptcy, Detroit’s approach to the 2005 debt has been to argue that the whole borrowing was illegal from the start because the city had reached its debt ceiling. It contends the deal should be voided, which would result in hundreds of millions of dollars in losses for both Syncora and Financial Guaranty.

In fact, until Syncora’s announcement on Tuesday that it had an agreement in principle with Detroit, both insurers stood to receive one of the lowest recoveries of the bankruptcy. That outcome would have significant negative implications for the municipal bond industry because it would leave Detroit’s pensioners higher on the creditors’ pecking order than the investors who bought Detroit’s debt in 2005.

The investors had no idea Detroit would later call the borrowing illegal, because the underwriters obtained legal opinions from both the state and independent bond counsel that the debt was valid, binding and enforceable.

It would be highly unusual for a government to repudiate debt marketed with such assurances. Municipal bond analysts have been warning that if Detroit prevails, it will cast a shadow over every other city bringing debt to market in the future.

Complicating matters, when Detroit borrowed in 2005, it tried to hold down the cost by issuing variable-rate debt, then hedging it with a type of derivative called interest-rate swaps. The swaps were intended to protect Detroit if interest rates rose — but if they fell, the city would have to pay the swap counterparties, which happened to be Bank of America and UBS.

The two insurers wrote guarantees for both the debt instruments, called certificates of participation, and for the interest-rate swaps. That protected the investors who bought the certificates and Bank of America and UBS from any missed payments on the swaps.

The borrowing was considered so innovative in 2005 that it won a Deal of the Year award from The Bond Buyer, a trade publication, and was said to have solved Detroit's pension problem once and for all. But by 2009, interest rates had plunged, and Detroit's mandatory swap payments to the two banks ballooned beyond anybody's expectations.

With cash flying out the door, the city's fiscal problems grew bad enough to activate provisions requiring it to terminate the swaps — but that required Detroit to buy out the two banks at the full present value of all the swap payments it would otherwise have to make for the life of the certificates. Once again, it did not have the money.

Detroit bought some time by restructuring the swaps and backstopped its obligations to the banks by pledging the cash it receives from a tax on casinos, an important source of revenue for the city.

After that, Detroit kept right on paying the swaps, even after declaring bankruptcy last year, when it estimated the cost of terminating its swaps at about $345 million. The city and the banks did reach a proposed settlement of $165 million, but the judge rejected it.

"It's just too much money," Judge Rhodes said at the time, and he ordered both sides to negotiate a lower deal. A few weeks later, the banks accepted $85 million.

Syncora's lawyers saw that the banks planned on turning their losses on the swaps into insurance claims that it and Financial Guaranty would be expected to pay.

That is what Syncora and the two banks will be thrashing out in their closed-door sessions this week. Financial Guaranty is not participating in those talks but has been in touch with Detroit about other possible settlements.

Both insurers say that if the 2005 borrowing was in fact illegal, as the city says, then they were fraudulently induced to insure it. If so, then their policies are also void, they say, and they do not owe the banks any money.

No one wants to touch the third rail underlying all this: If the 2005 borrowing was truly illegal, and must therefore be voided, then the city pension system should be required to give the investors back the $1.4 billion they provided back in 2005. That would sink Detroit's hard-won exit strategy.

THE NEW YORK TIMES
By MARY WILLIAMS WALSH
SEPTEMBER 10, 2014 7:10 PM

August Muni Volume Rises 7%.

Municipal bond volume increased in August from the same month in 2013, raising expectations that issuance may inch closer to normal in the fourth quarter.

Monthly Data

Long term bond sales for August totaled $24.4 billion, a 7% increase from August last year, according to Thomson Reuters. This is the second time in three months that volume has come in higher than the same month of 2013, after June issuance rose 16%.

Municipal bond supply has been scarce all year, totaling $177.2 billion as of July 31, 15.3% below 2013's level for the same period, according to data provided by The Bond Buyer and Ipreo. Some analysts said that August's strength is an indication the drought will finally end and issuance will pick up during the fourth quarter.

"The amount of issuance this year has been startlingly low," Jim Colby, chief municipal strategist at Van Eck Global, said in an interview. "Given where rates are I can't imagine we won't see issuance pickup in Q4, with issuers taking advantage of rates."

Colby pointed to declines in municipal yields as an indication of a the seller's market that will exist for the rest of the year. The benchmark 10-year triple-A general obligation bond has fallen by 71 basis points to 2.08% as of Aug. 28, from Jan. 2, according to Municipal Market Data.

From Aug. 1 alone the benchmark 10-year bond's yield dropped by 21 basis points.

John Dillon, managing director at Morgan Stanley Wealth Management, said in an interview that he doesn't predict a substantial turnaround in volume for the rest of the year. Volume looks good only in comparison to a weak period for issuance last year, he said.

Volume plunged in the middle of 2013 as the Federal Reserve signaled it would end its economic stimulus program and Detroit's bankruptcy fanned credit concerns.

"I think given the major downshift we saw in volume in May and June of last year, gives us better optics now," he said. "So the market looks like there's better volume now. Its not August volume being good, just last year's comparison's being easier to beat."

He said, though, that the lower interest rates create an opportunity for refundings to pick up during the fourth quarter. Refundings totaled $9 billion in August, more than double the volume in the same month in 2013.

"We will continue to see refundings pick up a little bit more, especially during the end of the year, when we will have more refundings on the table," he said.

Refunding volume in August was boosted by the $1.8 billion Detroit Water and Sewage Department deal Citigroup priced on Aug. 26.

Many of the Detroit Water and Sewer bonds came wrapped in bond insurance from Assured Guaranteed and National Financial, helping boost bond insurance volume by 174.4% to $2.5 billion. Last year insured bond volume totaled $896.6 million for August.

"It could just be because of Detroit, that would obviously be a factor, but it's still positive momentum" for bond insurers, Dillon said.

New money issuance stayed low and was 15.3% below the August 2013 amount, totaling $10.1 billion.

Both negotiated and competitive issuance increased from the same period last year, by 18.3% to

$18.2 billion and 2.8% to $5.8 billion, respectively.

Colby said issuance is likely to pick up after the midterm elections, as politicians, who had shied away from borrowings that could be portrayed during reelection campaigns as increasing the debt burden, return to the market.

He said during elections voters are often asked to approve additional funding for road repairs, schools, and other such projects.

“What does happen when you go into fourth quarter for the calendar year is that local and state officials start looking at what want to accomplish before end of calendar year and say ‘we have all this authorized but unused capacity, maybe should raise our issuance level because interest rates are favorable and demand is there’,” Colby said. “I’ve seen it occur in past years.”

THE BOND BUYER
BY HILLARY FLYNN
AUG 29, 2014 1:42pm ET

Muni Managers Unearth Secondary Market for Price Discovery.

Some municipal fund managers are finding it’s possible to use the secondary market to help determine fair bond pricing after a drop in new issuance has limited their reliance on the primary market as a benchmark.

While many market participants prefer to gauge prices in the secondary market against large, recognizable, liquid new issues, they said current secondary trading levels and trade history provide a reasonable alternative, thanks to strong demand for paper.

“There is enough going on in the secondary market for reasonable price discovery,” said Jim Colby, chief municipal strategist at Van Eck Global, in an interview Aug. 28. Price discovery in the secondary market often comes via the strength of the bid-offered side of the market – which Colby described as “pretty firm” from June through last week. “If we are evidencing demand by searching for bonds, that’s every bit an effective and an important way of determining value,” he said.

Long term bond issuance has declined 12% this year through August to $203.25 billion, according to Thomson Reuters figures, even after increases in two of the last three months. At the same time demand for tax-free yields has propelled inflows into muni funds for much of the year, including an eight week stretch through Sept. 3, according to Lipper FMI.

“Secondary market price discovery is not necessarily difficult because customers who are putting bonds out for the bid are getting pretty decent numbers,” a New York trader at a Wall Street firm said. “It’s hard to keep bonds on the shelf.”

New issuance of familiar names is what really aids price discovery and establishes a benchmark, Colby said.

“When it’s Texas, California, or New York, those issuers are trend-setters or market-setters in terms of valuation – everybody will readjust their views based on what those scales look like,” Colby said.

“Those not involved on a day to day basis might think less of that process, but I’m looking for a big

New York State or Maryland deal to be representative" of value, Colby said.

The New York trader agreed that most municipal participants view the primary market as the main driver of the municipal industry, when it comes to pricing and establishing relatively attractive levels to entice investors. "Most deals have been well-received and have later traded up in the secondary," the trader said.

"If there's a lot of relative value in the primary, investors will forgo the secondary," where he said higher prices can sometimes prevail in the absence of healthy new issue volume, the trader said.

Some participants, meanwhile, prefer to negotiate for what they deem a fair price in the secondary market based on recent trade history, thereby, creating the two-way, bid-wanted and bid-offered sides of the secondary market.

"There is a basis for narrowing down some sort of value and I think that can happen on any given day" in the secondary market – even when new issuance is lackluster, Colby said.

Others said price discovery and value in the secondary has recently been possible due to the strong investor appetite for municipal bonds and steady support from the bid-offered side of the market at a time when new issuance has lagged.

"I think with the Street not heavy and with last week clearly having a holiday feel and not a lot of issuance, it's not necessarily difficult finding a bid for bonds," the New York trader said.

"The market is pretty apathetic after last week," he said on Tuesday, referring to the post-Labor Day market climate.

Meanwhile, the pace of the new-issue market often affects ebbs and flows of the secondary market, experts said.

"To the extent the volume is lower on the new-issue side, it tends to slow down activity in the secondary," said Tom Dalpiaz, managing director at Granite Springs Asset Management LLC said in an interview on Thursday. "When new issuance is robust and there's a lot of deals you tend to see more things out for the bid in the secondary market as people sell bonds to make room for new issues."

He said traders, analysts, and investors are still able to uncover value in the secondary in the absence of large, benchmark deals in the primary market.

"When big deals are priced – people view it somewhat as a benchmark for levels, but with diligence you can find some good value in the secondary," Dalpiaz said in an interview on Thursday.

Dalpiaz is part of a team that manages $200 million in total assets under management, two-thirds of which is municipal assets.

He focuses much of his attention in the secondary market, and said he tries to analyze comparisons to big new issues in the primary market -if and when available.

"The new issue market is a sign post which can be very active, or very quiet, but the secondary market grinds along and goes about its business," regardless of the pulse of the primary market, Dalpiaz said.

In fact, many portfolio managers that do heavy credit surveillance, he said, are often less reliant on the “deal of the week” in the primary and are more accustomed to “looking under every rock” to reveal value in the secondary, Dalpiaz said.

In addition, many municipal players also use the benchmark scales published by Municipal Market Data to gauge the accuracy of pricing and value in the secondary market on a daily basis, managers said.

Others take their cue from municipal pricing and valuation services, like Interactive Data Corp. and Standard & Poor’s Securities Evaluation, often known by its original branding, J.J. Kenny, sources said.

IDC offer millions of independent evaluations of fixed income securities, while Standard & Poors Securities Evaluation offers advisory services, including evaluated pricing and model valuation of fixed-income securities.

The Municipal Securities Rulemaking Board also offers a price discovery tool on EMMA that allows retail investors to view the prices and yields of up to five securities in a side-by-side comparison, as well as daily highs and lows trading trends in a move that satisfies regulators’ demand for more price transparency.

“Secondary market trading has flurries and moments of activity when new deals have come into the marketplace,” Colby said. “Traders have supported that after-market activity and are very supportive of sellers looking to reposition or raise cash for new issues.”

In addition, he said sellers can feel “pretty confident” putting bonds out for bid when they know there’s not going to be “a wave of bonds coming into the new-issue marketplace that diminishes the bid side.”

Dan Heckman, senior fixed income strategist at U.S. Bank Wealth Management, said investors can either use historical data to gauge the price and valuation of a bond, or use the new issue market as a benchmark.

“We would probably prefer price discovery via where new issues are,” he said in an Aug. 29th interview. “We shy away from just solely accepting pricing in the secondary market [as a gauge of value] – unless we know what someone paid for it.”

“We certainly would want to look at other benchmarks, like the new-issue market, because you can look at new issues today, yesterday, and last week that are pretty current as a better way of how pricing can get done,” Heckman said.

THE BOND BUYER
BY CHRISTINE ALBANO
SEP 5, 2014 11:58am ET

New Borrowing Drags Down U.S. Municipal Bond Sales in August.

(Reuters) – Issuance of U.S. municipal bonds edged down last month as new borrowing saw the slowest August in 17 years, Thomson Reuters data released on Tuesday shows.

Debt sales totaled $24.1 billion in 834 deals, compared with $24.72 billion in 795 deals in July. A year earlier in August, issuance was only $20.97 billion in 733 deals. Altogether, issuance for the year through Aug. 31 was 12.5 percent behind the same period in 2013.

New borrowing totaled $9.79 billion in 449 deals, the smallest August since 1997 when new debt totaled $9.27 billion in 693 deals. In July, borrowers sold $10.5 billion new bonds in 399 deals.

Refunding, on the other hand, ticked up in August. Refinancing totaled $14.31 billion in 385 deals, compared with $9.75 billion in 245 deals in August 2013. That was also stronger than July, when there were 396 refunding deals totaling $14.22 billion.

Last year, as interest rates began rising from historic lows, cities, states and other public authorities ended their refinancing binge. But recently rates have fallen as demand for municipal bonds picks up.

On Municipal Market Data's benchmark scale, yields on top-rated 10-year municipal bonds fell 20 basis points over the course of August to end the month at 2.07 percent, the lowest level since May 2013.

Yields on highly rated 30-year bonds fell to 3.03 percent on the last trading day of August, also the lowest since May 2013, according to MMD, a unit of Thomson Reuters.

Sep 2, 2014 11:39am EDT

(Reporting by Lisa Lambert; Editing by Leslie Adler)

Ballard Spahr: Congress Passes Highway Funding Bill; Includes Pension Funding Relief.

Last week, Congress gave final approval to a $10.8 billion bill that will keep federal highway funds flowing to states through the busy summer construction season. While this short-term "patch" offers some relief, it is now the responsibility of the new Congress that will be sworn in next year to fashion legislation that can offer a long-term solution to pay for mass transit systems and repairs to bridges and highways across the country.

The vote came after weeks of debate regarding appropriate funding mechanisms for the struggling Highway Trust Fund (Fund), and hours before the government was set to begin cutting payments to state construction projects. The Fund was created as a user-supported fund. Simply, the revenues of the Fund were intended to finance infrastructure projects, with the taxes dedicated to the Fund paid by the users of the infrastructure. The Fund pays for highway and mass transit projects across the country, but it is now nearly exhausted because gasoline taxes—which finance the Fund—have not been able to keep up with spending. President Obama has indicated he will sign the bill into law.

A number of factors have contributed to the Fund's struggles, and for years lawmakers have sparred over how to deal with the annual funding shortfalls. The federal gasoline tax of 18.4 cents a gallon has remained unchanged since 1993, and has not been able to keep pace with the rising costs of construction and rehabilitation of transportation projects. Adjusted for inflation, the tax should now be approximately 29 cents a gallon. Further, with crumbling highways and bridges and greater demand for transportation infrastructure, the needs have grown, but the dramatic advances in fuel efficiency have substantially eroded the amount of gasoline tax funds coming in. The value will erode much further as new fuel efficiency standards take effect over the next decade.

The measure passed by Congress transfers $10.8 billion into the Fund and reauthorizes it through May 2015. More than half of the cost is offset by changes to the pension funding rules for private sector pension plans, which would allow companies to assume higher interest rates in measuring pension liabilities. Higher rates will reduce pension liabilities, which, in turn, will reduce the tax-deductible minimum required contributions that companies must make to fund their pension plans. Reducing the tax-deductible contributions that are expected to be made to pension plans over the next few years will bring new tax revenue to the federal government. Of course, this short-term pension funding relief comes at the possible expense of the long-term financial stability of employer-sponsored defined benefit pension plans.

August 4, 2014

by Brian Walsh, William C. Rhodes, Steve T. Park, Christopher R. Sullivan, and Brian M. Pinheiro

Attorneys in Ballard Spahr's P3/Infrastructure Group routinely monitor and report on new developments in federal and state infrastructure programs. For more information, please contact P3/Infrastructure Practice Leader Brian Walsh at 215.864.8510 or walsh@ballardspahr.com, William C. Rhodes at 215.864.8534 or rhodes@ballardspahr.com, Steve T. Park at 215.864.8533 or parks@ballardspahr.com, Christopher R. Sullivan at 215.864.8508 or sullivanc@ballardspahr.com, or the member of the Group with whom you work.

Ballard Spahr's Employee Benefits and Executive Compensation Group regularly advises clients on the design, implementation, operation, and communication of employee pension and benefit plans. For more information, please contact Employee Benefits and Executive Compensation Practice Leader Brian M. Pinheiro at 215.864.8511 or pinheiro@ballardspahr.com, or the member of the Group with whom you work.

CA Passes Enhanced Infrastructure Financing Districts Legislation.

It looks like Governor Jerry Brown's vision for Enhanced Infrastructure Financing Districts will become law. Meanwhile, a minor revival of redevelopment has also reached the Governor's desk but Brown appears likely to veto it.

In the closing days of the California legislative session, a bill expressing Brown's longstanding goals for Infrastructure Financing Districts (IFDs) came to the floor through a gut-and-amend of SB 628, by State Sen. Jim Beall, D-Campbell. The substitute amendment went on the record Tuesday, August 26. It passed the Legislature without further amendment in the year's closing session early Saturday morning, August 30, and was sent on to the Governor.

If, as expected, the Governor signs it, SB 628 would expand the existing but underused mechanism of IFDs, with the idea that they could take up some former functions of the state's abolished local redevelopment districts. The mechanism would be simpler, more focused on infrastructure, and more dependent on electoral approval, without the flexibility or protections for the existing urban public that were built and bashed into Redevelopment over the years.

The bill's language reportedly came from the Governor's office. It was supported energetically by the California Economic Summit organization. (The Summit's op-ed-style case for the bill, which

Beall linked to prominently on his legislative Web site, is at http://bit.ly/1pfneLr.) But the bill alarmed housing advocates, who warned that it could lead to displacement of poorer neighborhoods as in the redevelopment "blight" clearances of the middle 20th century. And while the League of California Cities supported SB 628, the League's legislative director, Dan Carigg, described it as a "helpful" tool that should be one of several, saying it did not by itself replace the usefulness of redevelopment funding mechanisms to serve populated urban areas.

The Governor's press office, in response to a detailed request for comment, wrote: "SB 628 is consistent with the administration's previous proposal regarding infrastructure financing districts."

A very different bill, AB 2280 by Assemblymember Luis Alejo, D-Salinas, made it to the Governor's desk as of August 27 after extended negotiations (partly through its 2013 predecessor, AB 1080) that gathered support from business, local government and housing advocates. But the odds were still running against the Governor's signing it. AB 2280 would revive redevelopment-style tax-increment financing in narrowly chosen urban areas, with 25% affordable housing set-asides. Those provisions are more reassuring to housing and local-government advocates but more likely to trigger the Governor's opposition to former redevelopment mechanisms and his skepticism toward housing affordability restrictions.

Compared with its last formal expression in the May budget proposal revision, the Enhanced IFD's legislative language picked up two major changes in SB 628.

The bill removed a prior 55% popular vote requirement to create an Enhanced IFD, though it still requires a 55% vote for any such district to issue bonds. Carigg characterized this as the major change since May. But he still said the 55% requirement for bond issues made Enhanced IFDs more likely to be created where "it's less populated, or on the edge of town."

Legislative staff veteran Fred Silva, now a senior fiscal policy advisor to California Forward and staff to the California Economic Summit "infrastructure action team", said his group and the League had each advocated for the single 55% vote, to be required only at the stage of issuing bonds, rather than requiring two votes, first to create the district and then to issue the bonds.

Brian Augusta, a legislative advocate with the Western Center on Law and Poverty, noted SB 628 also softened a requirement on post-redevelopment disputes, appearing in the bill's proposed new Sec. 53398.54 of the Government Code. As of the May revise this provision would have blocked local governments and/or special districts from making use of the Enhanced IFD mechanism unless they first had "resolved all litigation" with the state over specified statutes related to the redevelopment dissolution process, involving either themselves or their successor redevelopment agencies. But in the parallel SB 628 provision, as Augusta noted, "it says that they can't use any assets of a former redevelopment agency that are the subject of litigation [involving the state] to 'benefit' the new IFD entity."

The requirement remains in place in SB 628 that each would-be Enhanced IFD creator must first receive a Department of Finance "finding of completion" regarding assets managed by the successor agency for its former redevelopment agency.

Augusta wrote that the requirement to resolve litigation "was a big sticking point, I am told, in discussions between the Governor's office and legislative leaders. Apparently the revised language was satisfactory to both sides."

The Governor had been pushing all year to expand the IFD mechanism to perform selected redevelopment functions, rather than re-enact the old Redevelopment laws and processes. (See http://www.cp-dr.com/node/3480 on the post-Redevelopment picture as of mid-spring, http://www.cp-dr.com/node/3492 on the IFDs proposal in the May revise.)

The relevant May Revise language is at http://bit.ly/1qqn4ol. For comparison the SB 628 bill as passed is on the state legislative tracking site at http://bit.ly/Z38wlC.

Silva said the May revise already reflected a policy his group had supported: authorization to include vehicle license fee “backfill” funds as a source of IFD financing.

Carigg said that over the Legislature’s summer break the League sought something more along the lines of Sen. Lois Wolk’s SB 33, which was not successful in the 2013-14 session. He still saw a need to have some financing mechanism available that is patterned after “the proven tool of the past, which is redevelopment.” He said, “If you’re going to be realistic about the challenges of urban California,” addressing them would take more than SB 628.

Housing advocates said the bill did not contain adequate protections against displacement, nor any requirements to fund or build affordable housing. They warned that housing protections of these types were painstakingly added to redevelopment law because of lessons learned from the slum-clearance devastations of the twentieth century, and dropping them risked having to learn those lessons over again.

Augusta’s concern was for the possible loss of affordability and anti-displacement legal protections reflecting 70 years of lessons learned on redevelopment. He said it took creation of Redevelopment’s low- and moderate-income housing fund and the 20-percent housing set-aside obligation to stop the program’s original gentrifying effects, together with replacement housing requirements and housing production requirements assuring that affordable housing would be built in redevelopment areas. Although SB 628 does include some housing replacement and relocation protections, he described it as a redevelopment tool of a type “that often drives gentrification, displacement” without including the old tools that were developed to prevent it. Hence he called it “kind of half a loaf.”

He said those concerns were expressed to the Assembly and the Governor’s office but word came back that SB 628 in its current form was what the Governor was willing to sign.

The bill does provide some anti-displacement and relocation provisions, including that if an IFD removes affordable housing, it must be replaced within two years by “the construction or rehabilitation, for rent or sale to persons or families of low or moderate income” of an equal number of units if the removed units were home to people of “low or moderate income,” or 25% of the units if the residents themselves were not of “low or moderate income.” Affordability restrictions are to apply for 55 years to rentals or for 45 years to “owner-occupied units,” with an alternative option to set up an equity-sharing agreement.

Silva said housing advocates were concerned, though, he argued, unduly so, about the bill’s definition of “low or moderate income” by reference to Health and Safety Code Sec. 50093.

Section 50093 under current law defines “Persons and families of low or moderate income” as “persons and families whose income does not exceed 120 percent of area median income,” adjusted for family size. The current official state income limits under Sec. 50093 appear at http://www.hcd.ca.gov/hpd/hrc/rep/state/inc2k14.pdf. They give San Francisco’s area median income for a four-person household in 2014 as $103,000 per year and Los Angeles County’s as $64,800 per year. As of early 2013 the maximum CalWORKS cash aid payment for a household with four eligible persons was $762 per month. (See http://bit.ly/1pvGGtf.)

While some spoke of fixing the legislation in a later cleanup bill, policy director John Bauters of Housing California sent a furious series of Twitter messages during the SB 628 gut-and-amend's brief pendency to liberal legislative leaders, once calling it a "horrible bill" and repeatedly saying "#SB628 will displace people of color from their communities. Vote NO!"

Arriving on the floor late and suddenly, the bill was not amended. Housing advocates had hoped to add an anti-displacement amendment but could not. Silva said in addition to housing relocation provisions, he expected cleanup legislation on the process for forming districts and setting up their financing with public participation — especially the question of whether a city that initiated formation of a district should be the only author of its financing plan, if the district included other local governments or districts as partners.

Silva said the bill's history was an instance of "one of the dilemmas where the Administration is working through the elements of a proposal and is not prepared to have a proposal heard and worked on by a legislative policy committee."

Augusta said work on a cleanup bill was likely to start in January, with any cleanup amendments likely to take effect in the fall of 2015 — timing that might not be a huge problem because he didn't expect "a gold rush" to create IFDs after the bill's signing.

He said, "The administration and the Speaker have committed to working next year to clean up the relocation and replacement housing provisions, and that's good. We are also looking to have the broader conversation about putting in place requirements and funding for affordable housing, because that is a key anti-displacement tool that is missing from this."

Silva argued that the objectives of the new Enhanced IFDs would be to create infrastructure, not so much to build housing. He suggested the example of a five-square-mile district, partly within a city limit, for which a city, its surrounding county, and the local water district might choose to layer together their tax increment eligibilities to cooperate on financing a stormwater capture project. Multiple districts would be most likely to agree on infrastructure types of projects, he suggested.

Silva noted that cities have extremely varied policy positions on whether to favor affordable housing, and said "we're silent on that question because the Economic Summit wanted to [make] tools available as opposed to requirements that said, 'whatever you're going to do, you have to set money aside for a particular purpose'," because "purposes are always going to be different." He said his own group and the Governor's office had concluded adequate tools were needed for infrastructure investment, not "the old redevelopment model that had more of a target to reduce blight."

Responses by the Western Center on Law and Poverty to relevant parts of the May Revise are at http://bit.ly/1lT16rZ and http://bit.ly/1lAtRqo.

The League of California Cities' response to the May Revise is at http://bit.ly/1lDa76W.

California Planning & Development Report
By Martha Bridegam
31 August 2014 – 2:35pm

Public Employees' Pension Dilemma.

The story has played out repeatedly in recent years. As unfunded pension liabilities rise, financially stressed local governments seek to move employees toward 401(k)-type retirement systems to get out from under crippling long-term commitments, but public employee unions fight to maintain their defined-benefit plans.

As the municipal landscape becomes more fiscally precarious, public employees might want to rethink the traditional strategy.

A couple of decades ago, it was almost unheard of for a municipality to declare bankruptcy. But fast forward to today and Bridgeport, Conn., Detroit and Stockton, Calif., and are just a few of the cities that have descended into bankruptcy. Pension problems even have Vallejo, Calif., which emerged from bankruptcy in 2011, in danger of declaring for a second time.

In Detroit, U.S. Bankruptcy Court Judge Steven Rhodes ruled that pension promises are not sacred in the city's bankruptcy proceedings, and the city's pensioners voted overwhelmingly to accept cuts. The city plans to pay most pensioners 95.5 percent of their promised monthly benefit and eliminate cost-of-living adjustments (COLAs) entirely. Police and firefighters would fare somewhat better; they would get 100 percent of their monthly benefit, but the annual COLAs would be cut from 2.25 percent to 1 percent. Rhode Island and the city of Providence are among other jurisdictions that have gone after COLAs in pension-overhaul legislation.

Given the spate of municipal bankruptcies and the fact that so many of them are pension-related, there's little doubt that moving toward 401(k)-style or defined-contribution plans, in which employers contribute to an employee's pension fund each pay period rather than promising a set benefit upon retirement, would help steady municipal finances. But it's also becoming clear that defined-benefit promises on which municipalities can't deliver don't help workers, who may well be better served by getting their employers' pension contributions through a defined-contribution plan.

Guaranteeing all previously promised pension payouts in return for substantial concessions from new hires is an approach that a number of cities have used to ease their pension problems. Atlanta saved $25 million annually by raising its retirement age for new hires. Lexington, Ky. extended its retirement age and also increased the period new employees have to work before vesting in the city's pension plan from 20 years to 25. And even if those Detroit retirees see their pensions cut and COLAs eliminated, they'll still make out better than new city workers. After 30 years, those new employees' pensions are projected to be worth about 40 percent less in inflation-adjusted dollars than those of city workers who retired in 2011.

The problem with this approach is that future public employees are the ones who would be most hurt by it, and they're not represented when the agreements are being negotiated.

Unfunded pension liabilities are one of the main reasons why municipal finances have become so precarious in recent years, and moving to defined-contribution plans would ease the fiscal pressure on cities. While the switch might not be the first choice for many employees of the nation's most troubled municipalities, it's a lot better than facing unilateral benefit cuts after they've already retired or as they near retirement.

But for municipalities facing pension woes that are serious but not yet at the crisis stage, it's tempting to solve the problem by shifting the burden to future employees who have no voice in current negotiations. That option isn't fair and would make the already formidable task of attracting and retaining top-flight public workers even harder in the future.

Governing.com

Charles Chieppo | Contributor
Charlie_Chieppo@hks.harvard.edu

SEPTEMBER 2, 2014

Driving Muni Bond Rally: Communities Reluctant to Borrow.

Rob Rapheal, president of the school board in Forest Lake, Minn., wants to tap the bond market to fix the community's aging public schools.

Earlier this year, he helped a team of parents, teachers and administrators put forward a proposal that aimed to raise $188 million to repair crumbling roofs, replace aging boilers and reduce debt-service costs.

"It was a real deal for the public," Mr. Rapheal said.

But the proposal was shot down in a special election, with 60% of voters rejecting the plan.

The vote reflects a force behind this year's rally in the $3.7 trillion municipal-bond market: states, cities and communities are unwilling or unable to borrow in the wake of the recession. That means the supply of securities available for investors is dwindling, driving prices higher.

"The market would welcome that paper, but if they can't issue it, we can't buy it," said Tom Metzold, vice president and senior portfolio adviser at Boston-based Eaton Vance Corp., which manages about $26 billion in municipal assets.

It isn't just voters constricting the market; state and city budgets in many regions remain austere since the recession ended in 2009 and officials may be reluctant to propose new taxes ahead of November elections. Others are concentrating on paying down unfunded pension obligations or other critical needs. Meanwhile, municipal-bond issuers already have refinanced large portions of their debt over the past several years, capturing low interest rates, and summer is typically a slow season for new bond sales.

As a result, there are many communities making the same choice as Forest Lake despite borrowing costs that are near generational lows. With or without input from voters, cities and states issued about $29.7 billion less debt during the first eight months of this year than in the same portion of 2013, according to data from the Securities Industry and Financial Markets Association, with about $203.5 billion issued through last month.

Many cities and states were burned in the financial crisis by bad deals on municipal bonds sold to pay for everything from highways in Massachusetts to renovations on Louisiana's Mercedes-Benz Superdome. Taxpayers refinanced billions in securities after auctions for variable-rate bonds collapsed, for example, and spent billions more to get out of derivatives that are often bought to hedge the same deals.

In 2006, politicians sought voter approval on a record $109 billion in bonds, according to Bond Buyer data. By 2009, that was down to $19.4 billion, with voters approving just $12.7 billion, the lowest amount since 1995. Presidential elections typically include many bond measures as public officials take advantage of high voter turnout, but 2012 resulted in the lowest value of new bonds of any presidential cycle since 2000. Last year, voters approved about $22.9 billion, around half the average of the previous 10 years.

“There’s a genuine demonstrated need for infrastructure, and yet states and municipalities are just extremely cautious about borrowing,” said Scott Pattison, executive director of the National Association of State Budget Officers. “From their perspective, revenue is coming in below expectations, growth is slow compared to before the recession, the feds are creating uncertainty, so we’re going to continue to be cautious.”

Water damage at the high school Jenn Ackerman for The Wall Street Journal
The caution is likely to persist, say some analysts. Municipal-bond issuance will decrease to as low as $175 billion in 2017, Tom Kozlik and Alan Schankel said in a Janney Montgomery Scott LLC research report. They attributed the stagnation to interest rates that will eventually rise, austerity measures, high fixed costs for local governments and the lack of broad public policy supporting public works.

“There is nothing politically sexy about infrastructure spending,” they said in the report.

Many municipalities are cautious to take on new debt because economic growth in their regions is still slow, said John Bonow, chief executive of Philadelphia-based PFM Group, which advises cities and states on bond deals.

Texas, which includes seven of the nation’s 15 most rapidly growing cities, has sold the most debt in the U.S.—some $20.7 billion worth of bonds through mid-July. By comparison, the state issued $30.9 billion in all of 2013. California, meanwhile, has sold only $19.8 billion in bonds in the same time, trailing the pace that gave it a nationwide-high $47 billion last year, according to Ipreo data.

Officials are postponing anything that isn’t critical or important to public safety for a year or two until economic conditions improve, said Jamison Feheley, head of banking for public finance at J.P. Morgan Chase & Co.

Even when public officials push ahead, voters are rejecting more debt, with the value of approved bonds falling to about two-thirds of those proposed in the three years immediately after the crisis, from an average of more than three-quarters in the three years prior. And while that total rose to 72.7% in 2013, school districts were still below that level and less likely to get voter approval than utilities, transportation or general-purpose debt, according to Bond Buyer data.

Voters in Neosho, Mo., have twice this year rejected a plan to raise property taxes to pay for a new junior high school. In central Ohio last month, two plans to improve facilities at local school districts went down in defeat.

In Forest Lake, the school board hasn’t had a bond referendum pass since Bill Clinton was president. The area is part of Minnesota’s Sixth congressional district, and represented in Washington by former presidential hopeful Michele Bachmann, known for taking a stance against raising taxes. Many Forest Lake schools are now about a half-century old, with antiquated fire and security systems and leaky roofs. A high-school running track hasn’t been usable in a decade. After a $24 million bond proposal failed in 2010, the district built a community task force that toured the schools and spent about eight months developing a plan for how to approach repairs and renovations.

Those included redesigning entrances for better security, closing outdated buildings, repairing roofs, replacing ancient boilers, merging two junior high schools and expanding the high school.

If voters had approved the debt, the district would have made all necessary repairs by 2018, adding arts facilities, a new pool, a track and a football field. The plan would have increased taxes on the average area household by about $200 a year, according to the district. The current levy generates about $850 per student, the lowest in the district's athletic conference.

The school district's superintendent Linda Madsen said the area's residents didn't oppose the plan in an organized way, and state legislators wrote letters of support to the local papers. But, as the results began to roll in on the evening of Election Day, she said it was clear the plan wouldn't pass.

The district's schools are making do by not using the track and planning to use fans instead of new air conditioning.

"Nothing's changed," Mr. Rapheal said. "The type of repairs we need to do are still there. Unless we address them, we're going to end up having catastrophic failures. Really, bonds are a very good way to finance building."

THE WALL STREET JOURNAL
By AARON KURILOFF
Sept. 4, 2014 6:17 p.m. ET

GFOA Award for Best Practices in School Budgeting.

GFOA is a leader in developing, communicating, and encouraging best practice implementation in budgeting and financial planning. GFOA's most recent project is to enhance the existing Distinguished Budget Presentation Award for school districts and community colleges. Through this project and with the help of some of the best minds in the field, GFOA will develop best practices for resource alignment, as well as criteria by which districts and colleges can demonstrate budget process excellence.

Over two years, GFOA's Research and Consulting Center will be working with practitioners, researchers, and other education finance experts to identify the best ways for PK-12 and community college institutions to leverage the budget process to align their resources to student outcomes. In addition, GFOA will also develop award criteria that allow districts and colleges to demonstrate process excellence and receive the recognition they deserve. GFOA will then observe the outputs in practice through a number of pilot projects in order to test the best practices and award criteria. Based on the lessons learned during the pilots, GFOA will finalize the criteria and incorporate them into the Distinguished Budget Presentation Award program criteria for the 2016-2017 budget year.

Read more.

More Detail Needed in GSA 'Swap-Construct' Exchanges, GAO Concludes.

The General Services Administration (GSA) needs to do a better job of outlining what the government hopes to gain when it offers "swap-construct" exchanges for federal properties, according to a new report from the Government Accountability Office (GAO).

Since 2012, the GSA has offered six swap-construct exchanges, which would allow the GSA to swap the titles of federal properties for construction services or assets. However, the agency has only completed two of the deals since 2000.

The companies told the GAO the exchanges, which took three years in one case and five years in the other, took longer than expected.

Other companies told the GAO they were concerned about the lack of detail from the GSA's construction needs.

The report recommends that the GSA include more detail on what it is seeking in exchange for a federal property when it proposes a swap-construct exchange. Further, it should develop criteria for when to pursue such exchanges rather than simply disposing of unneeded of federal property.

The GSA is currently considering a swap-construct exchange for the FBI headquarters in Washington, D.C., and has narrowed its choice to three options, Greenbelt Metro and Landover in Maryland, and the other at the GSA Franconia Warehouse Complex in Springfield, Va.

WSJ: Mow-Down in Motown.

Bond insurers have a good case against Detroit for unfair treatment in bankruptcy.

Federal Judge Steven Rhodes will begin hearings Tuesday to determine whether Detroit's readjustment plan fulfills the legal and fiscal requirements to exit Chapter 9 bankruptcy. The trial may provide investors a lesson, instructive but painful, in how politics can override law in municipal bankruptcies.

Since declaring bankruptcy in July 2013, Detroit has cut deals with nearly all of its major creditors. Workers, retirees and most bondholders this summer voted to accept the plan. Yet Judge Rhodes must still validate that the plan is "fair and equitable" and was proposed in good faith, among other standards of Chapter 9.

The reality is that some creditors are making out far better than others with similar legal standing. The city has offered general-obligation bondholders 34 to 74 cents on the dollar. Voluntary Employee Beneficiary Associations will administer reduced health benefits, and pensions will be modestly trimmed under a deal negotiated by the court's mediator.

The state, the Detroit Institute of Art and some philanthropies have pledged $816 million to shield the city's artwork from monetization. These proceeds will exclusively fund pensions and minimize benefit cuts. Accruals for non-public safety workers will be pared by 4.5% in lieu of the 26% emergency manager Kevyn Orr proposed earlier this year. The city has even agreed to restore cost-of-living adjustments and accruals in nine years if the pension funds are flush.

In other words, the plan patently favors workers and retirees over bond insurers Syncora and Financial Guaranty Insurance Company that have similar legal standing. To their current regret, the two companies insured $1.4 billion in certificates of participation (COPs), a common form of government financing, that the city issued last decade to shore up its pension funds. According to the city's calculations, insurers stand to recover at most 10 cents on the dollar, which is 30 to 50 cents less than the pension funds. Does the city really consider this distribution equitable and fair?

Under Chapter 9, a city isn't required to monetize its assets. However, it can't requisition assets to goose the recovery of a single creditor as Detroit has done with its art. As a counter-example, imagine the political blowback if the city had decided to sell its Belle Island to make bond insurers whole and no one else.

Detroit has tried to browbeat Syncora and Financial Guaranty into settling for the mere 10% by suing to void the COPs. In 2005 Detroit politicians circumvented their state-imposed debt limit by creating “service corporations” and intermediary pension-fund trusts to issue the COPs. They provided third-party legal opinions to investors validating the framework.

But earlier this year the city sued its service corporations to undo the COPs transaction, even as it wants to keep the $1.4 billion it borrowed. If the transaction was invalid, then the city can’t retain the proceeds. This would be as if Argentina sued itself in international court for issuing bonds in alleged violation of its sovereign laws and then refused to repay its lenders. The legal terms for this are fraud and theft.

Detroit is supposedly seeking to rehabilitate its political culture, so it’s not a good sign that it’s trying to pull a fast one on creditors. The cynicism is reinforced by the city’s agreement to pay banks 30 cents on the dollar for interest-rate swaps tied to the COPs. If the COPs are invalid, why aren’t the swaps too?

Retirees and unsecured GO-bond holders have also been promised a higher recovery if courts undo the COPs transaction. By dangling this fillip, the city induced the unsecured bondholders to support the plan.

Trouble is, if courts void the COPs, the pension funds may be required to disgorge the $1.4 billion and interest. That could render the pension funds insolvent. Since the COPs litigation could extend past bankruptcy, Detroit might face another fiasco down the road.

Bankruptcy allows municipalities to break contracts and restructure obligations, but in return they are required to treat creditors fairly. Institutions and individuals lend on the presumption that courts will enforce the law. If municipalities can mow over creditors and the rule of law in bankruptcy, they deserve to pay a political-risk premium to borrow, assuming anyone is still foolish enough to lend.

THE WALL STREET JOURNAL
Updated Sept. 1, 2014 5:55 p.m. ET

SEC Rating Agency Reforms Positive for Munis.

WASHINGTON – The Securities and Exchange Commission’s new credit rating agency reforms seem to make some positive strides for the muni market by creating parity between municipal and corporate bond ratings and increasing rating methodology transparency, sources said.

The rule, adopted on Wednesday by a 3-2 vote, codifies requirements of the Dodd-Frank Act of 2010 that were put in place because of mistrust stemming from credit rating agencies giving high ratings to securities that ended up defaulting and contributing to the financial crisis.

The rules for rating agencies, designated by the SEC as nationally recognized statistical rating organizations, or NRSROs, require them to put in place policies and procedures designed to ensure quality control of the ratings, publish a certificate with every rating that discloses the methodology used and limitations or uncertainties of the score, and apply rating symbols universally for all obligations.

The reforms of most concern to the muni market are effective nine months days after publication in the Federal Register.

Under the new rules, the rating agencies will have to have policies and procedures in place designed to assess the probability than an issuer will default, a positive for munis, which have lower default rates than corporate bonds.

Dustin McDonald, director of the Federal Liaison Center at the Government Finance Officers Association, said issuers had been eager to see munis rated the same way as corporate bonds.

Because muni defaults are extremely rarely relative to corporates, market participants and lawmakers including retired Rep. Barney Frank, D-Mass., pushed for a universal scale. A BNY Mellon analysis published last year showed that three years after being rated A, muni bonds had a default rate of about one in 10,000, versus about 41 out 10,000 A-rated corporate bonds. The NRSROs also will have to publish material changes to their procedures or methodologies, the reason for the change, and the likelihood that the change will cause current ratings to change.

“I would definitely view that as a positive,” McDonald said.

Other aspects of the rule are designed to curtail potential conflicts of interest, and forbid rating analysts from participating in sales and marketing activities. The agencies must also perform “look backs” and revise ratings that were improperly influenced by business considerations, such as the prospect of future work for the issuer.

SEC chairman Mary Jo White, who joined with commissioners Kara Stein and Luis Aguilar in approving the rule, said it was necessary to crack down on compensation arrangements or performance review procedures that incentivize analysts to award inflated ratings.

“We must address these channels of influence if we are to prevent the full range of potential conflicts of interest that can lead to deficient credit ratings,” she said.

Aguilar said the SEC could go even further by evaluating the “issuer pays” system, which is common in the muni market. Issuers pay the rating agencies a fee in return for getting a rating, which they need in order to effectively market their bonds.

“The commission should consider proposing rules that would more directly address the conflicts that arise when rating agencies are paid by the very issuers of the products they rate,” Aguilar said. “This conflict of interest continues to jeopardize the quality of credit ratings today. If we are to restore integrity to the ratings process, the commission must address this conflict of interest in a meaningful and effective way.”

Commissioners Daniel Gallagher and Michael Piwowar voted against the rule, saying it created a compliance nightmare, particularly the prohibition on marketing activities influencing analysts.

“This new prohibition is solely based on state of mind – there is no requirement that any action be taken,” Gallagher said. “Even if the rating process is effectuated without any abuse, we could theoretically still pursue the analyst unfortunate enough to display evidence that a stray thought related to sales and marketing considerations crossed his or her mind.”

Piwowar sounded similar concerns, and also voiced disagreement with the idea of a universal rating standard for all securities.

“I agree with the concern that credit ratings may be confusing and even downright misleading if they are not applied consistently,” Piwowar said of the rating symbols. “But academic research indicates that trying to achieve perfectly comparable rating scales is not only impractical – it is impossible. Despite any efforts by the credit rating agencies to maintain ratings comparability, the risk profiles of distinct asset classes are significantly different and thus result in varied performance of the instruments."

Rating agencies, which have waited for the rules for more than four years, expressed a readiness to comply.

"The markets must have clear and consistent rules for credit-rating agencies, and the SEC's regulatory framework will help ensure investors have confidence in the rating process," said Daniel Noonan, managing director at Fitch Ratings.

David Wargin, a spokesman for Standard & Poor's, said his agency is determining what impact the new rule would have.

"We are evaluating the new regulations to determine what changes to our operations may be required," he said. "We are committed to the highest standards in our ratings activities and complying with the new requirements."

Moody's Investors Service declined to respond to a request for comments.

THE BOND BUYER
BY KYLE GLAZIER
AUG 27, 2014 5:12pm ET

Derivative Deals Making Comeback for Municipalities.

Local governments in Pennsylvania are turning again to the kinds of derivative deals that backfired during the credit crunch, as the lure of up-front cash and the potential to cut costs prove hard to resist.

Dauphin County, for example, has cleared the way to enter an interest-rate swap on a deal that helped settle the debt of the once-insolvent state capital, Harrisburg. Berks County, which in 2009 spent roughly its parks and library budgets to end swaps, agreed to a new contract in March.

The governments are tapping swaps even as municipal borrowers, from Philadelphia's school district to California's water-resources department, have paid to end money-losing derivatives banks pitched as tools to lower borrowing expenses.

In 2009, Pennsylvania had the most local governments using swaps on variable-rate debt, Moody's Investors Service says.

"You've got to think long and hard before you take a risk that you have no control over," said Steven Goldfield of New York-based Public Resources Advisory Group, who helped develop Harrisburg's recovery plan. "As a governmental official with public funds, you want to preserve the funds."

Even after federal regulators pushed through rules sparked by the swaps fallout, public money remains at risk, say Pennsylvania state senators backing stronger restrictions. The measures, up for a vote as soon as September, would have barred the latest deals.

The swaps are contracts, typically between a bank and a borrower, to exchange interest payments. The agreements were intended to shield issuers from the risk of rising interest rates.

Yet market convulsions during the financial crisis often spurred expenses in excess of payments. Localities nationwide have paid more than $4 billion to Wall Street to terminate the derivatives, data compiled by Bloomberg show.

Swaps figured in the fiscal woes of Harrisburg, forced into the state's first receivership in 2011 after skipping debt payments on an incinerator project. A 2012 audit said derivatives tied to the deal boosted fees and risk.

Dauphin County backed the incinerator debt and made payments the city skipped. As part of the settlement that allowed Harrisburg to exit receivership in March, the county contributes a portion of the interest rate on $24 million in fixed-rate bonds that financed the incinerator's December sale, said Jay Wenger of Susquehanna Group Advisors, the county's financial adviser.

Last month, county commissioners approved an ordinance authorizing a deal called a swaption involving an up-front payment to the county Wenger says would go toward debt service. Royal Bank of Canada would have the right at a future date to compel the county to pay a floating rate in exchange for fixed payments until 2033.

Transactions involving immediate cash have "been the cause of 99 percent of the abuse in the market," said Lucien Calhoun of Flourtown-based Calhoun Baker, administrator of the Delaware Valley Regional Finance Authority, which provides municipal loans.

Dauphin has not entered into the contract. In 2011, it agreed to two swaps with RBC, effective in 2015 and 2016, that would cost about $626,000 combined to terminate, according to Susquehanna. Wenger said commissioners would do the third swap to manage their interest-rate risk, the same reason for the 2011 deals.

Berks County returned to the swaps market after losing money on earlier deals. In 2009, it paid termination fees totaling $13.8 million, filings show.

The March structure is a basis swap – the county pays a variable rate based on tax-exempt municipal bonds and receives from PNC an amount based on a taxable variable rate, documents show.

The March swap would save at least $2.6 million over its 23-year term, and reserves would cover exit payments, Finance Director Robert Patrizio said.

BLOOMBERG NEWS
ROMY VARGHESE
Friday, August 29, 2014, 1:08 AM

S&P: Detroit Water & Sewerage Department Bonds Undergo Various Rating Actions after Expiration of Tender Period.

(Editor's note: Standard & Poor's Ratings Services intends to assign a 'BBB+' rating to the untendered portion of the cusips of Detroit's outstanding bonds issued for the Detroit Water and Sewerage Authority (DWSD). In our media release related to the issue of series 2014C&D Michigan Finance Authority (MFA) bonds, published Aug. 26, 2014, we indicated that the rating on certain Detroit tendered cusips would be revised to 'D' and then withdrawn because we considered the tenders a distressed exchange. We now understand that these same cusips have been partially tendered and that no new cusips will be assigned to the untendered portion. Therefore, at closing of the 2014C and 2014D MFA bonds, we currently intend to revise the rating on the partially tendered portion of the affected cusips to 'D', and then assign a 'BBB+' rating to the untendered portion of the cusips. A corrected version of our media release follows.)

CHICAGO (Standard & Poor's) Aug. 26, 2014–Standard & Poor's Ratings Services has taken numerous rating actions on Detroit's outstanding sewage disposal and water supply revenue bonds, including the following:

We have lowered the rating to 'CC' from 'CCC' on tendered bonds purchased by Detroit below par or accreted value and considered impaired for most of the duration of the tender invitation period that began on Aug. 7, 2014. We have removed the ratings from CreditWatch, where they were placed with negative implications on July 3, 2013. The outlook on these bonds is negative. We have raised the rating to 'BBB+' from 'CCC' on all other tendered and untendered bonds and removed the ratings from CreditWatch; the outlook on these bonds is stable.

In addition, we assigned our 'BBB+' rating to Michigan Finance Authority's series 2014C and 2014D bonds (the MFA 2014C and D bonds), which are payable primarily from payments on Detroit Water and Sewerage Department (DWSD) obligations to be purchased with the proceeds of the MFA 2014C and D bonds. The DWSD obligations are secured by a statutory lien on pledged assets of each system separately (prioritized by the lien status), which include:

- Net revenues of the city's sewage disposal or water supply system,
- Investments credited to the sewer or water system, and
- Earnings on those investments.

DWSD has also entered into a trust agreement related to all sewer and water revenue debt. The trustee is Wilmington Bank N.A.

While we understand that the MFA 2014C and D bonds will be issued in various subseries as senior-lien and second-lien bonds, there is no difference in the ratings because our analysis is based on our opinion of DWSD's creditworthiness with regard to covering all fixed costs, and DWSD has indicated it plans to fund capital expenditures with bonds secured by all of its existing liens.

Proceeds of the DWSD obligations will be used to purchase tendered and redeemed bonds, and in the case of series 2014C-1 and C-2 bonds, to fund capital improvements for the sewage department. As the result of a tender invitation that started was effective on Aug. 7, 2014, and expired on Aug. 21, 2014, the city has agreed to purchase $1.468 billion of outstanding sewerage and water revenue bonds.

"All ratings that are 'CC' are considered to involve a distressed exchange in which bondholders are receiving less than the original promise," said Standard & Poor's credit analyst Scott Garrigan. At closing, we would expect to change the rating on the affected cusips to 'D'. We understand that these same cusips were partially tendered and that no new cusips will be assigned to the untendered portion. Therefore, at closing of the MFA 2014C and D bonds we currently intend to revise the rating on the partially tendered portion of the affected cusips to 'D', and then assign a 'BBB+' rating to the untendered portion of the cusips. Generally, we consider an exchange offer to be distressed if we believe that the bondholders receive less than originally promised, and if the bondholders are accepting the offer because of the risk that the issuer will not fulfill its obligations. Accordingly, we applied the 'CC" rating to those cusips that were considered both impaired prior to the tender invitation period and will be tendered at less than par.

Ratings on bonds with all other outstanding cusips, whether senior or second lien, are 'BBB+', as noted below.

"The 'BBB+' rating reflects our opinion of the underlying creditworthiness of the sewer disposal and water supply systems," continued Mr. Garrigan. "Even though the rating on bonds secured by the pledged assets of each system could diverge, at this time we believe the creditworthiness of each system is the same, regardless of lien position.

The rating is supported by our view of the following characteristics:

- The legal framework includes a statutory lien on net revenues, provisions under the city's current Plan of Adjustment (POA) that consider all DWSD-related bond claims as unimpaired, and an order entered by the bankruptcy court that, among other things, both precludes the city from filing future POA amendments that would impair any DWSD-related bond claims and that overrules all objections to the order and documents related to the 2014 DWSD bonds.
- Significant economic stress within Detroit partly offsets a much more diverse revenue stream from a large number of wholesale customers.
- Historical financial performance has been generally adequate as measured by days' operating cash and investments and total fixed-cost coverage, but the amount of accounts payable and allowances for doubtful accounts is significant.
- There is upward pressure on rates, in our view, due to the need to fund a large capital program and additional debt needs. Based on income indicators for the Detroit metropolitan area, we deem the rates affordable although, based on the significantly lower income indicators for the city of Detroit, we consider the rates high for customers located in Detroit.
- System leverage is high, and we do not believe that will abate given the large amount of debt needs to fund the current capital improvement program.

We also note that DWSD has been in the process of implementing many policies and procedures that we view as supportive of credit quality, especially as they relate to collecting delinquent bills, recovering a higher percentage of fixed costs, simplifying the wholesale contract and rate structures, and controlling operating expenses. DWSD's financial projections show generally better overall financial performance than has been attained over the past several fiscal years. Before raising the rating further, we would look for the systems to achieve and, in our view, to be able to maintain better financial performance over multiple fiscal years.

The negative outlook on the bonds rated 'CC' reflects our expectation that the rating will be lowered to 'D' once the tendered bonds are purchased.

The stable outlook on the bonds rated ‘BBB+’ reflects our expectation that the financial performance of both the sewer and water systems should be consistent with or better than projections. We base this expectation on our belief that as DWSD management continues to implement various policy and procedural changes, financial performance will likely improve because of the specific efforts aimed at improving collections, stabilizing the operating revenue stream, and controlling costs.

However, actual financial performance could be worse than projected, based on numerous events occurring. Economic pressures that limit collection rates and rate affordability could continue. Billed water volumes could decline due to a combination of weather or economic events. Additional environmental compliance mandates could lead to unforeseen capital and debt expenses. If one or more of these events occurred, and a direct negative impact on financial performance resulted, we could lower the ratings.

At present, the various events listed are possible causes of financial stress for nearly all public utilities. But we are pointing them out in this case to indicate that future upward movement in the rating would most likely be predicated on our belief that financial performance can be sustained in a fashion that insulates the utilities from the negative impacts these unforeseen events can have on credit quality. Most notably, sustained levels of unrestricted liquidity and coverage of all fixed costs that meet or exceed the current projections would be two performance metrics we would expect to have a significant positive impact on credit quality. For upward rating movement to occur, we expect these to be sustainable in future fiscal years, and to occur without significant additions of debt not currently identified in the CIP (of course, we do understand that beyond the current scope of the CIP, which ends in 2019, there could be additional, currently unforeseen debt issued).

The rating on the bonds secured by net revenues of the sewage disposal and water supply systems could diverge if we determine that there is enough of a difference in the relevant credit factors. However, it is difficult to foresee at this time whether that would occur or what the precipitating factors leading to such a divergence would be.

RELATED CRITERIA AND RESEARCH

USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008
USPF Criteria: Standard & Poor’s Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In U.S. Public Finance Revenue Obligations, Nov. 29, 2011
Criteria For Assigning ‘CCC+’, ‘CCC’, ‘CCC-‘, And ‘CC’ Ratings, Oct. 1, 2012
Rating Implications Of Exchange Offers And Similar Restructurings, Update, May 12, 2009
Related Research
U.S. State And Local Government Credit Conditions Forecast, July 8, 2014

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Primary Credit Analyst: Scott D Garrigan, Chicago (1) 312-233-7014; scott.garrigan@standardandpoors.com

Secondary Contact: James M Breeding, Dallas (1) 214-871-1407; james.breeding@standardandpoors.com

---

S&P - Analyzing U.S. Rate-Regulated Utilities: The Magic of Regulatory Assets and Liabilities.

Accounting for rate-regulated utilities is unique, because regulators can allow utilities to record costs in a period different from the one in which an unregulated company would report the same costs. Standard & Poor's Rating Services recognizes that this can lead to different financial results (see appendix).

Regardless of the specific accounting rules used or the financial statement presentation, our fundamental analysis of the credit quality of the U.S. utility industry follows the economic reality whether created by rate regulation or market forces (see "Key Credit Factors For The Regulated Utilities Industry," published Nov. 19, 2013, on RatingsDirect).

Continue Reading.

MMA Municipal Issuer Brief - Rating Trends - August 26, 2014.

Read the brief.

Moody's: High-Poverty US Cities Can Still Achieve High Credit Ratings.

New York, August 27, 2014 — A high rate of poverty does not preclude a large US city from having strong credit quality and attaining a credit rating in the upper investment grades, says Moody's Investors Service in a new report. In fact, in the report "High Poverty, High Ratings — 27 Large Cities Have Both," Moody's finds 27 of the 50 poorest large cities are rated Aa3 or higher.

Aa3 is also the median rating for the 50 large cities (population 100,000 or more) with the highest poverty rates. The median rating for all 210 large cities that Moody's rates is only one notch higher, at Aa2.

"Cities can overcome the many adverse effects of high poverty with a large and diverse tax base, healthy financial position, strong governance, and manageable fixed costs," says Moody's Associate Analyst Heather Guss. "We expect large municipalities with these characteristics to meet the challenges of a high poverty rate and continue to sustain robust credit profiles."

For all Moody's-rated cities with populations over 100,000, the rating agency finds a small correlation between higher poverty rates and lower ratings. The correlation is relatively weak (the correlation coefficient of 0.31), with a large number of outliers.

For example, Provo, UT, which is home to Brigham Young University, maintains a very strong rating of Aa1 despite a high poverty rate of 32.5%.

Poverty will invariably contribute to negative credit pressures such as weak tax collection rates and a high demand for government services. However, the credit positive features of a city can easily outweigh them.

Although large cities often have high poverty rates, they often play a central role in the economy of their region, leading to a strong tax base arising from institutions and also commuters, who bring revenues from income sales and parking taxes. For example, Cincinnati, which has a poverty rate of 29.4%, the nineteenth highest for a large city in the US, has a Aa2 rating due in part to a large number of corporate headquarters, healthcare organizations, and higher-education institutions.

Many cities also benefit from population growth as they attract young professionals who want to live near where they work. And many cities struggling with high poverty benefit from the significant institutional presence of government, military, healthcare and educational organizations. For example, Dayton, OH (Aa2 stable), with a poverty rate of 33.8%, borders Wright Patterson Air Force Base, the largest single-entity employer in Ohio.

Although many cities manage high poverty rates effectively, poverty remains a persistent challenge to local governments, says Moody's. Despite the ongoing economic recovery, the national poverty rate remains above prerecession levels. The 2012 poverty rate was the highest since 1993 after climbing 34.5% over the past decade.

For more information, Moody's research subscribers can access this report at https://www.moodys.com/research/High-Poverty-High-Ratings-27-Large-Citi-s-Have-Both–PBM_PBM174683.

WSJ: Fed to Consider Including Municipal Bonds in New Bank Safeguards.

Reconsideration Would Come Amid Broad Pushback From States, Treasurers to Muni-Bond Exclusion

WASHINGTON—The Federal Reserve, under pressure from lawmakers and state officials, is considering allowing banks to use certain types of municipal debt to satisfy a new postcrisis financing rule, according to a person familiar with the process.

On Wednesday, U.S. regulators are expected to finalize safeguards requiring that banks hold enough liquid assets—such as cash or those easily convertible to cash—to fund their operations for 30 days if other sources of funding aren't available. Municipal securities issued by states and localities wouldn't count as "high-quality liquid assets" under the rule, meaning such securities wouldn't qualify for use under the new funding requirements.

States and localities have warned that excluding their securities could cause banks to retreat from a

$3.7 trillion market in which they have increasingly become an important player, which could driving up borrowing costs to finance roads, schools and bridges. Banks have nearly doubled their ownership in municipal securities over the past decade to more than 11%, according to Fed data.

The Fed is now considering providing some relief in the coming months and may allow banks to include some types of municipal bonds as part of the new safeguards, the person said. The regulator is scrutinizing whether to eventually include more-frequently traded municipal securities but is trying to find a way of distinguishing which bonds it will accept, the person said. There are roughly 60,000 borrowers in the enormous municipal market but only a relatively small number—from large states and cities such as California and New York—see their bonds frequently traded, according to industry experts.

It is unclear if the Fed could act unilaterally to alter the rules, which are being written jointly with the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency.

The rules being finalized Wednesday are intended to prevent a repeat of the 2008 financial crisis when financial markets froze due to a lack of liquidity. Regulators want banks to have enough ready cash on hand so they can finance themselves if markets freeze as they did in the last meltdown. Among those assets that will qualify under the rule as "liquid" are Treasurys and highly rated debt issued by some foreign governments.

In their October proposal, the Fed, OCC and FDIC said they didn't include municipal bonds because "these assets are not liquid and readily marketable in the U.S." The regulators added that securities sold by "public-sector entities generally have low average daily trading volumes."

THE WALL STREET JOURNAL
By ANDREW ACKERMAN
Aug. 28, 2014 2:22 p.m. ET

Post-Implementation Review Completed on GASB Standard Addressing Capital Asset Impairment, Insurance Recoveries.

Norwalk, CT, August 19, 2014—An accounting standard for state and local governments that addresses the impairment of capital assets and insurance recoveries provides important information to users of financial statements and resolves some but not all of the issues underlying its purpose. That is a central conclusion of the Post-Implementation Review (PIR) of Governmental Accounting Standards Board (GASB) Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.

Issued in 2003, GASB Statement 42 establishes measurement guidance for capital asset impairments and requires governments to report the effects of those impairments when they occur, rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. It also provides uniform reporting guidance for insurance recoveries of state and local governments.

"The recent PIR Report has provided some important stakeholder feedback on the benefits of and the cost associated with the requirements of Statement 42 in light of actual experience," said GASB Chair David A. Vaudt. "On behalf of the GASB, I would like to thank the Foundation for undertaking this important process and all of the individuals and organizations who gave their time to share their insights and experiences with the PIR staff."

The PIR team received broad-based input from GASB stakeholders including auditors and preparers, and more limited input from financial statement users and academics. Based on its research, the review team concluded:

- Statement 42 resolved some of the issues underlying its stated need but may not have completely resolved all of them.

- In particular, users have mixed views as to whether Statement 42 achieved the two objectives for capital asset impairments: establishing recognition criteria for impairments, and requirements that appropriately measure the effects of impairments.
- For insurance recoveries, Statement 42 achieves the objective of establishing and clarifying guidance for accounting for insurance recoveries for all funds and activities.

- The capital asset impairment and insurance recovery information governments provide in their financial statements is important to users of financial statements.
- However, that information may be difficult for some users to understand and may not be as detailed or as comparable across governments as some users may wish.
- Most of Statement 42's requirements are operational but some stakeholders find certain aspects challenging. The primary operational concern, which was voiced by practitioners in particular, relates to the service utility approach and related techniques for measuring impairment of capital assets.
- Statement 42 did not result in significant changes to financial reporting and operating practices, nor did it result in significant unanticipated consequences.
- The cost to implement Statement 42 and the continuing application costs generally are consistent with the costs that stakeholders expected.
- Statement 42's expected benefits of improved user understanding for when capital asset impairments have occurred and enhanced comparability for insurance recovery information have been achieved. However, the expected benefit of improved user understanding of capital asset impairments' financial impact on governments may not have been achieved to the extent expected.

With regard to standard-setting process recommendations as a result of the review, the PIR team recommended that the GASB conduct, at a minimum, a limited field test when proposing to issue a standard with new recognition or measurement approaches, and share the results with users to assess the usefulness of the resulting information.

The review of Statement 42 was undertaken by an independent team of the Financial Accounting Foundation (FAF), the parent organization of the GASB and the Financial Accounting Standards Board (FASB). The team's formal report is available here. The GASB's response letter to the report is available here.

With the completion of the review of GASB Statement 42, the PIR team will initiate its review of GASB Statements No. 33, Accounting and Financial Reporting for Nonexchange Transactions, and No. 36, Recipient Reporting for Certain Shared Nonexchange Revenues, later this year.

Stakeholders who would like the opportunity to participate in upcoming PIRs should register online.

For more information on the PIR process, visit the FAF website.

[S&P: No More Pencils, No More Books - Technology Has Mixed Financial Implications for U.S. Public Schools.]

The growing integration of technology into U.S. classrooms, along with related innovations in instruction and assessment, is changing the way students learn and bringing both financial opportunities and challenges to U.S. public schools. To prepare students to become part of the new knowledge-based global workforce, schools, along with state and federal officials, are increasingly emphasizing the use of information technology — and are doing so earlier and earlier in the K-12 curriculum. While schools aim to harness technology to facilitate learning and operate more efficiently, incorporating technology can also make the already-complicated school funding arena even more complex.

Standard & Poor's Ratings Services believes alternative teaching methods and technology integration can have both positive and negative implications for U.S. public school credit quality. Using state-of-the-art technology or offering a virtual learning program can give a district a competitive advantage for students, resulting in increased enrollment-based aid. On the other hand, financing the cost of using physical technology — through operational funds, grants, or debt issuance — can be a challenge, whether the funds are for one-to-one computing devices or improvements to school facility infrastructure. The rapid pace of development, depreciation, and obsolescence of high-tech devices and supporting infrastructure may make it more difficult to project the expected life of assets and to structure debt financing accordingly. And by committing to new technology in the classroom, schools assume the risk that the ongoing cost of operating and maintaining new devices, and training staff to use them, will outstrip any gains associated with increased enrollment. Available funding sources and competition can vary widely across the states, but in most cases, state-level funding for technology adoption has been minimal relative to total education funding, and primarily geared toward one-time equipment acquisition and staff development costs.

Continue reading.

18-Aug-2014

City Finances and the Promise of Data Visualization.

New tools that make it easy to find and view government financial data are enabling big gains in efficiency and transparency.

For local governments, financial reporting is about more than simply ensuring that the numbers add up. Public officials also have to be able to communicate the data in a way that is both understandable and meaningful to target audiences, whether it's city officials making decisions about resource allocation or voters making decisions about whether to trust their governments.

That's the challenge for municipalities: How can local governments provide a comprehensive, yet accessible medium for distributing budgetary and other financial data? And from a practical standpoint, how can city leaders make this happen with limited resources and staff capacity?

Increasingly, the solution is data visualization. By linking enterprise performance systems to tools that provide instant access to current and historic financial records, more and more governments are allowing almost anyone to view and manipulate public data via vivid pie charts and line graphs.

Users can even export raw numbers or high-impact graphics for use in meetings and communications materials.

In Boston, for example, the city's performance management system, Boston About Results, uses data analytics and visualized scorecards from the software company SAP to evaluate agency operations and improve the delivery of services. Other municipalities have opted to partner with industry experts such as the Sunlight Foundation, OpenSpending and OpenGov to bridge the gap between city finances and public awareness.

In the San Francisco Bay area, Sausalito and Atherton are among the latest to join a network of more than 100 cities that have adopted OpenGov's platform. Sausalito is integrating data visualization into every aspect of city administration, including its recent labor negotiations. In the past, compiling labor costs from various agencies was an immensely arduous task that required sifting through hundreds of Excel worksheets to document the town's history of employee salaries and benefits. Charlie Francis, Sausalito's administrative services director and treasurer, reports that he can now review and visualize annual labor costs in a matter of minutes.

Francis thinks budget visualization has the power to reshape the landscape of local governance while improving efficiency and public understanding. On the efficiency side, he says the town has seen remarkable savings in staff hours and monetary costs since adopting its transparency platform just a few months ago. And several Sausalito city council members have taken to pulling up budget data on their tablets in the middle of presentations with residents, civic leaders and other stakeholders.

"When it comes to responding to a citizen requests about government spending, there is nothing more powerful than being able to access the entire city's financial records with just a few clicks," says Francis. "What is even more exciting is the fact that this is the same information that residents can access from the comfort of their home, and that citizens feel empowered to go back to the software and find answers to their other questions about government spending."

Atherton City Manager George Rodericks agrees: It all comes down to transparency. "The traditional process of financial reporting leaves the overwhelming majority of residents out of the loop," he says. "We needed a new medium that would not only be user-friendly but also equip regular citizens with the tools needed to ask the right questions about how city officials are spending their tax dollars."

With a three-member finance department, Atherton is always seeking opportunities to streamline its financial management process, and Rodericks says this platform is enabling him and other city staffers to do just that. Rather than having to personally respond to every request for financial information, for example, city officials now list frequently asked questions on Atherton's city website and link them to corresponding charts.

"This technology has transformed the way that residents interact with local government," says Rodericks. "On one hand, the open government platform is saving us hundreds of work hours by reducing the time that staff spends sorting through files of accounting data. On the other hand, as more citizens are using this technology we are starting to see many new inquiries come in from people interested in learning more about how local government operates."

This, of course, is a great problem to have. By providing residents with the tools to visualize and work with government data to meet their individual needs, financial data visualization is not only increasing government transparency and accountability but also enhancing the ability of local governments to be more responsive to citizens' needs.

GOVERNING.COM
BY STEPHEN GOLDSMITH | AUGUST 20, 2014
stephen_goldsmith@harvard.edu

Fitch: Detroit Water/Sewer Tender Would Not be a Distressed Debt Exchange.

NEW YORK, Aug 21, 2014 (BUSINESS WIRE) — The City of Detroit's (Detroit) Aug. 7 tender offer for all Detroit Water and Sewerage (DWSD) bonds, if fully executed, would not constitute a distressed debt exchange (DDE), according to Fitch Ratings.

The tender invitation, made through and with the approval of its various officials, includes the Bonds proposed to be impaired under the Fifth Plan of Adjustment (POA) and those that were listed as unimpaired. Fitch has evaluated the terms of the tender offer in the context of Detroit's bankruptcy.

The tender offer is not an attempt to avoid a payment default or default on other terms of the DWSD Bonds. The proposed treatment in the POA was intended to create an opportunity to call bonds at par that are not currently callable, to achieve savings, and to facilitate a potential conversion of DWSD to a regional utility or, more remotely, a privatized utility. It was not motivated by any financial distress within the DWSD itself. The tender offer is not conditioned on the tendering bondholders agreeing to any amendments to the indenture that would impair the rights of non-tendering holders.

The offered tender prices are intended to reflect current market prices. Additionally, roughly 90% of the bonds proposed to be impaired under the POA would be purchased at par or higher prices. Two percent of the proposed impaired bonds with tender prices below par are Capital Appreciation Bonds with maturities between 2016-2021, and those tender prices are more reflective of the current accreted value as opposed to the full value at maturity.

Further, bond prices below par appear in both the proposed unimpaired and impaired classes of the bonds. As noted in Fitch's DDE criteria, a cash tender below par is not a DDE unless combined with a consent solicitation to amend restrictive covenants (that would impair rights of non-tendering bondholders).

If the tender process is completed, Detroit will amend its POA and list all DWSD Bonds as unimpaired. Detroit intends to currently refund the tendered bonds that are purchased. Detroit has a conditional commitment from financial institutions to purchase the refunding bonds used to pay the purchase price. Bonds that are not tendered will not be altered and will continue to be entitled to payment of scheduled principal and interest according to the original terms.

The Bonds are revenue bonds of the respective water and sewer system (the System) secured by first or second liens, as the case may be, on the net revenues of the respective entity. A key assumption underpinning the ratings currently maintained is that the bonds constitute "special revenue obligations" under Chapter 9 of the US Bankruptcy Code. As such, in Fitch's view, they are legally protected from impairment in Detroit's Chapter 9 proceedings given the clear intent in the Bankruptcy Code to carve out debt secured by special revenues.

The POA, however, listed about 43% of these Bonds (by par value) as impaired based on a proposal to remove the call protection, reduce interest coupons and subordinate bondholder security interests in certain circumstances. The bondholders rejected the POA. The bond trustee, an ad-hoc committee of certain large bondholders and others have filed objections to the POA, which has raised material legal issues. Fitch's believes the impairment to the Bonds would likely be resolved against Detroit if pursued fully in the judicial process.

The failure of the tender offer or its rejection by Detroit will not result in the DWSD defaulting on the special revenue obligations. It would restore the parties to the terms of the POA and the DWSD Bond impairment could only then be confirmed by cramming down the DWSD bondholders. Fitch does not view confirmation of the plan and such a cram down to be a likely outcome.

Fitch notes that under Michigan law, all bonds are payable solely from the pledged System net revenues. The DWSD bonds are secured by a statutory lien on the pledged net revenues. Under Detroit charter, revenues collected for the Systems can only be used exclusively for the Systems and their debt and not in support of operations of Detroit unrelated to the Systems. Fitch also notes that certain federal court orders require Detroit to treat the enterprises separately from Detroit as they provide services to the region. Further, the lien on the net System revenues and payments of amounts due on the Bonds during a City bankruptcy are given special protection under the terms of Chapter 9 of the bankruptcy code.

The financial health of Detroit, which is impaired despite the relative financial health of DWSD, would in Fitch's view not benefit from the cram down in any material way. In fact Fitch feels a cram down of the DWSD bonds would likely be harmful. Impairing otherwise healthy and performing special revenue debt despite the protections of federal, state and City law may make it more difficult for Detroit to issue special revenue obligations in the future.

Detroit filed a Sixth POA yesterday which generally reflects the tender process as described above. This Sixth POA provides some further information on a potential regional Authority for the operations of the System. Additionally, this POA indicates that to the extent any tendered Bonds are accepted and the process concludes, all DWSD Bonds will be unimpaired. However, if no tendered bonds are accepted then the impairment status for the Bonds generally reverts to that described in the Fifth POA.

Fitch currently rates the DWSD's senior and subordinate Bonds 'BB+' and 'BB', respectively. Fitch also has the Bonds on Rating Watch Negative.

Additional information is available on www.fitchratings.com.

SOURCE: Fitch Ratings

Fitch Ratings
Thomas McCormick, +1 212-908-0235

Managing Director
Fitch Ratings, Inc., 33 Whitehall Street, New York, NY
or
Dan Champeau, +1 212-908-9188
Managing Director
or
Doug Scott, +1 512-215-3725
Managing Director
or
Media Relations:
Elizabeth Fogerty, +1 212-908-0526
elizabeth.fogerty@fitchratings.com

MMA Municipal Issuer Brief - California Leads the Way.

Read the Brief.

MMA Research Seems to Counter Some Concerns About S&P Ratings.

Municipal Market Advisors' recent research on ratings seems to counter recently raised concerns that Standard & Poor's ratings for some local governments may be too high and out of step with current credit conditions.

Tom Kozlik, an analyst with Janney Capital Markets, expressed these concerns in a report last month and suggested S&P's higher ratings would increase the potential for rating shopping among issuers. Nuveen last December expressed concerns about S&P upgrades of tax-backed municipal credits during the Great Recession.

But MMA's ratings research, published in an article in its latest Weekly Outlook, provides a different view. MMA summarized the results of its recent survey of split ratings from S&P and Moody's Investors Service on the same municipal bonds, as well as an examination of market share among the rating agencies.

"This is just data," said Matt Fabian, an MMA managing director, "I think it shows, at a minimum, that if S&P is trying to use its ratings to increase its market share, it's not working."

MMA said the prevalence of split ratings increased to 46% in mid-August from 43% in November of last year. The advisory firm looked the universe of 108,000 outstanding municipal Cusips with ratings from both Standard & Poor's and Moody's Investors Service that were uninsured, non-refunded, fixed rate, and with an investment grade rating from Moody's as of Aug. 15 and compared those results to a similar survey it did as of Nov. 27, 2013.

"Consistent with the last time, split ratings are more likely at lower rating categories, with S&P more often the provider of the higher rating," MMA said.

In addition, MMA found rating splits have increased at different rates in different rating categories as of the third quarter of this year. For example, 54% of Cusips with a Baa1 rating from Moody's had a different rating from S&P, compared to 43% last year.

Until now, many market participants have contended that S&P's upgrades on its methodological adjustments and Moody's bearish view on fundamental credit quality would help S&P catch up to the higher ratings produced by Moody's recalibration in 2010, MMA said.

But this latest "data imply that S&P's ratings continue to move up and away from Moody's," the advisory firm said.

However, MMA said, "At this point, we caution against thinking that S&P's ratings, in being higher, are necessarily less accurate. To the contrary, MMA believes that, in an asset class with such low default and impairment experience, higher ratings are better supported by the data."

General obligation bonds have a default rate over the last year of 0.03%, with default defined as an "ongoing, uncured payment default on bondholders," MMA said.

Defaults of tax-backed appropriation credits are more prevalent, but are still only 0.23%. The default rate is 0.03% for water/ sewer bonds and 0.06% for electric power bonds, the advisory firm said.

MMA said that S&P's higher ratings may result from a difference in methodologies, especially with respect to loss-given-default expectations and perceptions of willingness to pay dynamics, as well as a more optimistic view of fundamental credit vectors. But it said it "find[s] little evidence" that S&P is trying to buy market share.

"In fact, the opposite appears to be occurring," the advisory firm said. Market share for S&P this year is 81.3%, compared to 72.1% for Moody's and 48.8% for Fitch Ratings. But while Moody's is 9.2 percentage points behind S&P, it lagged behind S&P by 7.9 percentage points last year. Fitch's market share gap with S&P has widened to 32.5 percentage points this year from 32.0 last year. For uninsured bonds, Moody's and Fitch have actually closed their market share gaps with S&P slightly compared to last year.

MMA suggested that Moody's may be becoming less negative in its ratings.

"There's been a slowing pace of downgrades compared to upgrades in recent quarters, suggesting greater stability and marginal improvement in overall sector quality," the firm said.

THE BOND BUYER
BY LYNN HUME
AUG 21, 2014 9:28pm ET

Fitch: CalPERS Decision Raises Pension Obligations.

Fitch Ratings-San Francisco-22 August 2014: A recent decision by the board of the California Public Employees' Retirement System (CalPERS) will raise funding pressures on public employers, Fitch Ratings says. The state, school districts and local governments are already facing materially higher projected contributions caused by past investment results and recent actuarial changes intended to improve the sustainability of the plans over time. We expect legal and institutional battles to continue given the high stakes of pension reform for both public employers and employees.

The actuarial value of CalPERS' unfunded pension liabilities was $57.4 billion, as of the most recent valuation date. The Aug. 20 decision expands the definition of pensionable compensation for most newly hired public workers, allowing temporary and special assignment payments, among numerous categories of compensation outside of workers' base pay, to be included along with base pay in pension calculations.

The expanded definition of pensionable compensation exposes public employers to higher pension liabilities and contribution expenses, and appears to be a step backward from recent reforms. The Public Employees' Pension Reform Act of 2013 (PEPRA) narrowed the definition of pensionable compensation for public employees in an effort to address "pension spiking," the inflation of base pay for purposes of pension benefit calculations. This decision expands the definition of pensionable compensation, in apparent conflict with PEPRA, and will increase pension costs for public employers if implemented.

The magnitude of impact from this decision is not yet clear, but it raises more questions about the sustainability of California's pension reform efforts, which continue to face legal and institutional challenges. Particularly worrisome to Fitch is the absence of detailed information on the analysis of its projected costs. The decision has been sharply criticized by Gov. Jerry Brown, who cited its conflicts with recent state legislation intended to reduce pension costs. City-led pension reform efforts in San Diego and San Jose remain mired in litigation while this CalPERS decision appears to open up a new front for challenging reform efforts.

Contact:

Stephen Walsh
Director
U.S. Public Finance
+1 415 732-7573
650 California Street
San Francisco, CA

Doug Offerman
Senior Director
U.S. Public Finance
+1 212 908-0889
33 Whitehall Street
New York, NY

Rob Rowan
Senior Director
Fitch Wire
+1 212 908-9159

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

WSJ: Regulators to Complete Bank 'Liquidity' Rules.

WASHINGTON—States and localities could be on the losing end of new bank rules aimed at ensuring large financial firms have enough cash to operate during a crisis.

U.S. regulators are expected to finalize safeguards next month that large banks hold enough safe assets—such as cash or those easily convertible to cash—to fund their operations for 30 days if other sources of funding aren't available.

But the regulations are not expected to consider bonds issued by states and localities as "high quality liquid assets"–meaning such securities wouldn't qualify for use under the new funding requirements, according to people familiar with the matter. States and localities warn that could cause banks to retreat from the $3.7 trillion municipal bond market.

"The conclusion reached by the regulators is astounding in our view," said Tom Dresslar, a spokesman for Bill Lockyer, treasurer of California, one of the largest issuers in the municipal-bond market. "It makes no sense and it's against the public-policy interests of the U.S., not to mention the states and local governments."

The rules, which are under consideration by the Federal Reserve, Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency, are intended to prevent a repeat of the 2008 financial crisis when financial markets froze due to a lack of liquidity. Regulators want banks to have enough ready cash on hand so they can finance themselves if markets freeze as they did in the last meltdown. Among those assets that will qualify under the rule as "liquid" are Treasurys and highly-rated debt issued by some foreign governments.

Large states, big banks and some lawmakers have mobilized to beat the back rule, which they warn will raise borrowing costs to finance roads, schools and bridges if banks retreat from the market. That effort has fallen on deaf ears, with regulators doubtful banks would abandon the municipal bond market because banks purchase municipal bonds to earn money—rather than to meet financing requirements—so their behavior is unlikely to change because of the new safeguards, according to a person familiar with the matter.

"There's a lot of angst over it, but we don't think it's going to have a real impact" on the market, the person said.

Banks have ratcheted up their purchases of municipal securities in recent years and currently hold about 11% of all outstanding bonds, up from about 7% in 2004, according to the Fed. Yet regulators estimate only about half of those holdings are at large banks that will be affected by the rules. In their October proposal, the Fed, OCC and FDIC said they didn't include municipal bonds because “these assets are not liquid and readily marketable in the U.S.” The regulators added that securities sold by “public sector entities generally have low average daily trading volumes.”

State and local officials insist that is not true and say municipal bonds meet every criterion the agencies established to define “high quality liquid assets,” such as relative price stability during crises and lower risk of default than other securities. While individual municipal securities are often thinly traded, state and local officials who borrow money in the market say that is because most investors hold their securities until maturity and not because the market is illiquid.

Ben Watkins, the head of bond finance in Florida, said the proposed rules would drive up borrowing costs and crimp the amount of infrastructure projects states and localities can finance.

“We’re higher rated than the federal government and we’re certainly better managed financially,” said Mr. Watkins, noting Standard & Poor’s Ratings Services rates the Sunshine State triple-A but has downgraded the U.S. to AA+.

Robert Donahue, a managing director at Municipal Market Advisors, said the decision to exclude state and local securities is “counterintuitive” because the debt has low default rates and under the 2010 Dodd-Frank financial law, banks have to conduct additional research to ensure they only own high-quality municipal bonds.

“If this creates a drag on bank buying of munis, that would be an unfortunate consequence of this ill-advised exemption,” he said.

By ANDREW ACKERMAN
Aug. 22, 2014 1:58 p.m. ET

SIFMA Announces Changes to the SIFMA Municipal Swap Index.

New York, NY, August 18, 2014 – SIFMA today announced it has made changes to the SIFMA Municipal Swap Index to enhance benchmark transparency, reliability and access for all users.

Effective August 20, 2014 the index will use only data that has been reported to the Municipal Securities Rulemaking Board (MSRB), and therefore is subject to regulatory oversight, in its weekly benchmark calculation. Specifically, the index will use Variable Rate Demand Obligation (VRDO) reset rates reported to the MSRB’s Short-term Obligation Rate Transparency (SHORT) system under MSRB Rule G-34. The Index Criteria will reflect that only reset rates reported to the MSRB’s SHORT System will be eligible for inclusion in the weekly Index calculation.

Additionally, the index will now be freely available to all users at the same time, at no cost, with no need for a subscription.

In order to accommodate these changes, SIFMA has contracted with Bloomberg to serve as Calculation Agent for the Index. Users can access the index on SIFMA’s website (www.sifma.org/swapdata), Bloomberg’s website (www.bloomberg.com), or via the Bloomberg Professional service.

The SIFMA Municipal Swap Index is a seven-day high-grade market index comprised of tax-exempt VRDOs and serves a benchmark for pricing municipal swap transactions. The changes we are making are consistent with the robust principles for financial benchmarks recommended by the

Global Financial Markets Association, which is SIFMA's global affiliate. More information on the index is available here: http://www.sifma.org/research/item.aspx?id=1690.

GFOA: Public Pension Investment Returns Increase by 16.9% for Year.

In the year ended June 30, 2014, U.S. state and local-government pension investments earned the highest returns seen in three years, according to a report from Wilshire Associates, as reported by Bloomberg. Public pension returns increased by 16.9%, the best performance since fiscal 2011, when returns increased by 21.2%. Funds with more than $1 billion in assets performed best, with a median increase of 17.4%, attributed to larger alternative asset allocations. In the 10 years ended June 30, U.S. public pension investments returned 7.3%. Assets of the 100 largest public funds rose to $3.2 trillion as of March 31, up by $1 trillion since the first quarter of 2009, according to U.S. Census Bureau data.

Friday, August 22, 2014

Municipal Bond Issuance Trending Down After Five Months of Gains.

"Though we're seeing a distinct downward trend in municipal bond and international debt-related issuance volume, the overall capital markets picture is still very strong as we peer a little deeper into the second half of 2014," said Richard Peterson, Director, Global Markets Intelligence, S&P Capital IQ. "Clearly, actions by the Federal Reserve and European Central Bank will eventually have an impact on these numbers, but, for now, we are seeing signs of continued strength in new security issuance volume."

Read Press Release.

August 14, 2014

SIFMA Makes Changes to Muni Swap Index.

Some market participants have questioned the transparency of MMD's indexes, and in 2012 regulators reviewed how muni market benchmarks are set. Some sources thought that the Securities and Exchange Commission's comprehensive muni market report that year would raise questions about the indexes, but it did not.

Beginning Aug. 20, the Securities Industry and Financial Markets Association's Municipal Swap Index will use only data that has been reported to the Municipal Securities Rulemaking Board in its weekly benchmark calculation.

SIFMA made the announcement in a release, saying the change is due in part to the fact that the data will be subject to regulatory oversight.

The index was created as a joint venture between SIFMA and Thomson Reuters affiliate Municipal Market Data in 1992 to provide market participants with a short-term index reflecting variable-rate demand obligation activity. It is used as a benchmark for pricing municipal swaps. Until now, MMD has provided the calculations for the index based on information reported from remarketing agents directly to Thomson Reuters.

Going forward, Bloomberg will calculate the index based on numbers pulled directly from the MSRB's Short-term Obligation Rate Transparency system, or SHORT, SIFMA said. The SHORT system receives information and documents about securities bearing interest at short-term rates under MSRB Rule G-34 on CUSIP numbers, new issue and market information requirements.

Some market participants have questioned the transparency of MMD's indexes, and in 2012 regulators reviewed how muni market benchmarks are set. Some sources thought that the Securities and Exchange Commission's comprehensive muni market report that year would raise questions about the indexes, but it did not.

The index will be freely available to all users at no cost with no subscription required, SIFMA announced Monday. Users can access the index on SIFMA's website, Bloomberg's website, or via the Bloomberg Professional service.

THE BOND BUYER
BY KYLE GLAZIER
AUG 18, 2014 11:23am ET

SIFMA Announces Changes to the SIFMA Municipal Swap Index.

New York, NY, August 18, 2014 – SIFMA today announced it has made changes to the SIFMA Municipal Swap Index to enhance benchmark transparency, reliability and access for all users.

Effective August 20, 2014 the index will use only data that has been reported to the Municipal Securities Rulemaking Board (MSRB), and therefore is subject to regulatory oversight, in its weekly benchmark calculation. Specifically, the index will use Variable Rate Demand Obligation (VRDO) reset rates reported to the MSRB's Short-term Obligation Rate Transparency (SHORT) system under MSRB Rule G-34. The Index Criteria will reflect that only reset rates reported to the MSRB's SHORT System will be eligible for inclusion in the weekly Index calculation.

Additionally, the index will now be freely available to all users at the same time, at no cost, with no need for a subscription.

In order to accommodate these changes, SIFMA has contracted with Bloomberg to serve as Calculation Agent for the Index. Users can access the index on SIFMA's website (www.sifma.org/swapdata), Bloomberg's website (www.bloomberg.com), or via the Bloomberg Professional service.

The SIFMA Municipal Swap Index is a seven-day high-grade market index comprised of tax-exempt VRDOs and serves a benchmark for pricing municipal swap transactions. The changes we are making are consistent with the robust principles for financial benchmarks recommended by the Global Financial Markets Association, which is SIFMA's global affiliate. More information on the index is available here: http://www.sifma.org/research/item.aspx?id=1690.

Tax-Free Rally Extended With August Supply Doldrums: Muni Credit.

The municipal-bond market's record winning streak shows no signs of slowing.

State and local debt has earned 0.8 percent this month through Aug. 18, on pace for the strongest August since 2011, Bank of America Merrill Lynch data show. Munis have gained each month this year, an unprecedented performance, pushing benchmark 10-year yields to the lowest since May 2013, according to data compiled by Bloomberg.

Slowing bond sales and sustained investor appetite have defined the $3.7 trillion market in 2014. This month is no exception: investors will probably face the skimpiest August calendar in three years, according to Chris Mauro, chief muni strategist at RBC Capital Markets. The issuance slump is helping munis defy forecasts that investors would lose money on tax-exempt debt in 2014.

"People have stopped holding their breath waiting for rates to go up, and that's one of the reasons why you're seeing demand continue," said Peter Hayes, head of munis at New York-based BlackRock Inc. (BLK) The world's biggest asset manager oversees about $122 billion in state and local debt.

Demand Feed

Sales have been in a yearlong decline, with supply 14 percent below the 2013 pace. States and cities will probably borrow about $22.4 billion in August, Mauro said. Meanwhile, investors will receive about $36.7 billion from principal and interest payments. Three years ago this month, municipalities sold $19.4 billion of debt, and the market earned 1.5 percent.

"The market feels fairly constructive even at these low rates," Mauro said from New York. "Supply looks exceedingly manageable."

This year is shaping up to be a reversal of 2013, which was the worst for munis since 2008 in part because of Detroit's record bankruptcy filing.

At year-end, analysts at Morgan Stanley and Barclays Plc projected rising interest rates and further losses in 2014. Citigroup Inc. strategists suggested selling in April, when 10-year AAA yields were at 2.4 percent, or about 0.2 percentage point above the current level.

Yields have dropped in the past month as cash flowing into muni mutual funds chased limited supply. Muni mutual funds added $648 million last week, the fourth-biggest inflow this year, Lipper US Fund Flows data show.

Tax Haven

There is little expectation that bond offerings will pick up. Research firm Municipal Market Advisors said in a report this week that it sees "thin prospects" for fourth-quarter sales. Janney Montgomery Scott LLC has said issuance will drop every year through 2017.

For some investors, lower yields are no deterrent. Even as there are fewer bonds to choose from, higher federal tax rates are boosting the appeal of munis' tax-free interest payments.

This year, high earners faced tax bills that for the first time included federal tax increases that took effect last year: a top marginal rate of 39.6 percent, up from 35 percent; and a 20 percent tax on long-term capital gains and dividends, up from 15 percent. The top tax bracket is the highest since

2000.

The increases coincide with a 3.8 percent tax on investment income applied to top earners last year as a result of the 2010 Patient Protection and Affordable Care Act.

With a peak federal tax rate of 43.4 percent when including the levy on investment income, the 2.18 percent yield on benchmark 10-year munis is equivalent to a taxable rate of about 3.9 percent. Ten-year Treasuries yield 2.4 percent.

The lack of supply "has led to the continued grab for bonds in the primary market and compression of spreads," said Joe Gotelli, who helps oversee $6 billion of munis at American Century Investments in Mountain View, California.

"Until a move in yields generates a change in perception that we're on the forefront of negative returns going forward, you could be in this environment for some time," he said.

By Brian Chappatta and Elizabeth Campbell
Aug 19, 2014 5:00 PM PT

To contact the reporters on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net; Elizabeth Campbell in Chicago at ecampbell14@bloomberg.net

To contact the editors responsible for this story: Alan Goldstein at agoldstein5@bloomberg.net Mark Tannenbaum

---

WSJ: New Rules Near on Credit-Ratings Firms.

SEC Set to Finalize Measures Aimed at Preventing Conflicts of Interest; Industry Drew Criticism After Crisis

WASHINGTON—Credit-ratings firms may soon face tougher restrictions aimed at preventing a repeat of the financial crisis.

The Securities and Exchange Commission is expected as early as this month to finalize new rules meant to better police the industry, according to people familiar with the process. The effort follows criticism that ratings firms failed to adequately sound alarms about flawed mortgage securities ahead of the housing meltdown.

The rules, expected to be somewhat tougher than those proposed more than three years ago, will take additional steps to ensure that the firms' interest in winning business doesn't affect ratings analysis, said the people familiar with the process.

Credit raters have been lambasted by critics and lawmakers over their actions in the run-up to the 2008 financial crisis. A 2011 U.S. congressional report cited widespread and sudden downgrades of mortgage-related bonds as being perhaps "more than any other single event … the immediate trigger for the financial crisis." The bonds had previously been given top-notch ratings by the firms.

Ratings firms have acknowledged they didn't fully anticipate the events of the financial crisis but add that regulators and other market participants were also caught off guard.

SEC Chairman Mary Jo White has made completing the rules a top priority as she works through a backlog of unfinished regulations required by the 2010 Dodd-Frank financial law. Consumer advocates criticized the rules proposed in 2011 as weak. The measures languished at the agency until Ms. White arrived last year.

“The proposed rules were so deficient that they wouldn’t protect against problems that occurred in the crisis,” said Micah Hauptman, counsel at the Consumer Federation of America, which backs tougher rules on the industry. “Chair White has said that the commission’s responsibility is much greater than simply checking a box and getting a job done, and this is a test case.”

An SEC spokeswoman declined to comment. Credit raters say they are more regulated than in the past and welcome chances to become more transparent.

Corporations and other bond issuers pay ratings firms to provide credit-risk grades for their deals, a setup that critics say gives firms an incentive to relax their criteria to win business. The firms say they are able to manage conflicts of interest. The SEC isn’t expected to alter the so-called “issuer pays” model used by ratings firms, but it will impose stronger internal protections to protect against conflicts.

While the rules proposed in 2011 would have restricted sales and marketing officials from participating in ratings decisions, the final rules are expected to also restrict company executives, the people familiar with the rules said.

The new regulations would also hand regulators more jurisdiction to take disciplinary action when companies break the rules. Under Dodd-Frank, “There are more arrows in the SEC’s quiver,” to penalize bad actors with the proposed rules, said Scott McCleskey, a former head of compliance at Moody’s.

The SEC rules also are expected to require more ratings disclosures for investors and create a clearer process to impose penalties for violations.

“The markets must have clear and consistent rules for credit-rating agencies, and a proper regulatory framework will ensure investors have confidence in the rating process,” said Daniel Noonan, a spokesman for Fitch Ratings, which is owned by Fimalac SA and Hearst Corp.

“Moody’s will implement and abide by the final rules as published by the SEC,” said Michael Adler, a spokesman for Moody’s Investors Service.

Standard & Poor’s Ratings Services spokesman Ed Sweeney said the company had beefed up its compliance department in recent years but declined to comment on the pending SEC rules.

For several years, the SEC’s Office of Credit Ratings, led by Thomas J. Butler, has conducted annual industry exams and monitored the companies. But the SEC inspections, for now, have largely focused on whether raters are following their own company guidelines around ratings methodology or conflict of interest.

Credit raters have already been required to comply with postcrisis regulations in Europe and Canada. In the U.S., companies have created their own safeguards and heavily invested in risk management and compliance staffing.

Companies say they would expect a period of several months to comply with the SEC rules, whenever they are finalized.

By ANDREW ACKERMAN and TIMOTHY W. MARTIN

Aug. 14, 2014 6:22 p.m. ET

Blackrock 3Q Muni Credit Highlights: Know What You Own.

Highlights

- The familiar names continue to make headlines, but overall creditworthiness in the municipal market is the strongest it has been in over five years.
- The approval of a bankruptcy-like process for public companies in Puerto Rico
- gave the rating agencies and investors reason for pause.
- We are watching the tobacco sector, as recent trends in cigarette consumption
- could harken trouble for future payments to tobacco bondholders.

Overview

On balance, the core of the municipal market remains on solid footing. State revenues have grown in each quarter of the past four years, according to the Rockefeller Institute of Government, though the pace of gain declined significantly in the third and fourth quarters of 2013. Weaker growth is projected for the first quarter of 2014 as well. Some of the softening in data may be due to the fact that many taxpayers accelerated their income from calendar year 2013 to calendar year 2012 to avoid the increase in federal taxes. The inconsistency in the recent data could make budgeting more difficult for states going forward.

On the expenditures side of the ledger, spending generally has remained muted. States are exhibiting a reluctance to borrow, in part due to political factors in a midterm election year. With 28 incumbent governors up for reelection in 36 states this November, few politicians want to risk rankling voters. This often results in inaction on important decisions. Onerous required pension payments are also limiting states' ability to invest. Fixed costs associated with pensions and other post-employment benefits (OPEBs) will continue to drag on state and local finances.

Meanwhile, an improving housing market (and stronger property tax collections) is providing important stability for local budgets. The public sector should continue to add jobs, providing a small boost to U.S. employment.

PERFORMANCE REVIEW (TOTAL RETURNS)

	Q2 2014	**YTD 2014**
By Rating Category		
A	2.71	6.73
BBB	3.54	8.70
High Yield/Non-Investment Grade	2.37	8.54
Non-Rated	3.72	8.87
By State/Territory		
California	2.85	7.04
New Jersey	2.07	6.00
New York	2.48	5.62
Puerto Rico	-1.38	5.93
By Sector		

Corporate Backed	3.39	7.91
Education	2.91	6.81
Hospitals	3.49	8.08
Housing	2.37	5.87
Land Backed	4.18	8.57
Lifecare	4.06	9.78
Tobacco	2.66	11.52
Transportation	2.97	7.21
Utilities	2.03	5.67

Source: S&P Indexes.

Places to Watch

Puerto Rico: The quick passage of legislation that would allow public corporations to restructure debt in a local process akin to bankruptcy is being received as credit negative. While general obligation (GO) and sales tax (COFINA) bonds are excluded for now, the current or any future administration could feasibly propose legislation to restructure these securities as well. In the short run, the new law may signal Puerto Rico's willingness to allow its corporations to selectively default to protect its GO security, but we believe the long-term implication is that the Commonwealth is broadly willing to accept default as an option. Moody's multi-notch downgrade to several public corporations, as well as its three-notch cut to the GO rating and five-notch demotion of COFINA bonds, underscores the significant shift from a strong inclination to pay bondholders to a willingness to dilute them. Overall, Puerto Rico's economy remains troubled, and we remain doubtful of any sustainable economic or fiscal developments in the near future.

Illinois: Efforts to address burdensome pension liabilities hit an obstacle when the Illinois Supreme Court ruled that subsidized health care premiums for retired state employees are protected under the state constitution. The decision centers on a 2012 law that allowed the state to charge retired workers for health care insurance premiums, which many had not had to pay (depending on length of service). Retired workers sued, arguing the changes violated a provision in the state constitution that declares pension benefits "shall not be diminished or impaired." Attorneys for the state argued the constitution did not specifically protect health care benefits. The justices, however, found "nothing in the text of the Constitution that warrants such a limitation" and ruled to protect the benefits. This ruling could signal trouble for another pension overhaul plan being challenged in court. The upshot could be potential ratings pressure and price underperformance, but we are not worried about a long-term default scenario.

New Jersey: All three rating agencies downgraded the state citing persistent and growing budget gaps and limited flexibility in resolving them. New Jersey faces reduced reserves, high overall leverage and large unfunded pension liabilities. The volatile budget season ultimately closed on time after Gov. Christie cut a planned $1.57 billion pension contribution. A Superior Court judge previously ruled that the governor's order to withhold $884 million in pension payments in FY 2014 was justified by the state's serious fiscal situation and limited time to amend the budget, but she withheld judgment on the FY 2015 payment cut.

California: Moody's upgraded California from A1 to Aa3, its highest rating in over a decade. The upgrade was based on improving debt metrics, strong liquidity, robust employment growth and recent governance changes. We are watching the pending expiration of temporary tax hikes (sales tax in 2016 and personal income tax in 2018) to discern the potential impact on credit and bond valuations.

Sector Watch

Utilities: Severe drought conditions in places such as California and Texas have led to increased conservation efforts and, in some areas, mandatory cutbacks in water consumption. While drought conditions, and decreased demand may lead to some financial underperformance for water utilities in the near term, we believe most are well prepared to manage through these conditions, having navigated similar circumstances in the past. Additionally, many utilities have invested significant capital to expand storage capacity, acquire additional water rights and supplement existing supplies through technology, including water reuse and desalinization. These investments should prove beneficial, as little drought relief is expected in these areas through the normally dry summer months.

Health Care: In response to concerns regarding wait times experienced by veterans seeking health care through the Department of Veterans Affairs (VA), Congress passed with overwhelming support the Veterans Access to Care Act. The upshot is that health care providers outside the official VA system may start seeing more veteran patients to alleviate delays in care. Any services provided by a facility not under an existing VA contract would be reimbursed at rates set by the VA, Tricare or Medicare, whichever is greatest. Private providers in the respective service areas will reap the most benefit. An example is in the Phoenix outpatient market, where Banner Health and Dignity Health could see an uptick in utilization.

Trend Watch

Employment: The public sector, especially local governments, has continued to add (net) jobs, providing a small boost to overall employment. Local jobs saw an increase of roughly 22,000 in May, with the bulk of the gains in education. This bounce is not unexpected, as school districts have begun to fully benefit from both the continued restoration of state aid and an improvement in property taxes as recent gains in property values are recognized in assessed valuations.

Bond Protections: Lower-rated issuers are taking advantage of investors' increased risk appetite and a lack of muni bond supply. For example, a marginally investment-grade Illinois health system offered bonds with virtually no legal protection for the construction of a hospital. The deal did not have a debt service reserve fund or a mortgage lien, protections investors typically require. With muni issuance down 50%, the acceptance of such "covenant-lite" deals is little surprise and a trend worth watching.

Quarterly Spotlight: Tobacco

With a return of 11.52%, tobacco was the best-performing sector in the S&P municipal indexes in the first half of the year, providing a return nearly double that of main index's 6.08%. What is driving this outperformance and is it sustainable?

Drivers of Performance

With yields still near historic lows and the Fed in no particular hurry to raise interest rates, investors are hungry for income. Tobacco bonds offer yield in a low-rate environment, attracting crossover buyers and improving liquidity.

While the tobacco sector represents only 1% of the municipal bond market, it is one of the more liquid sectors due to its deal size. To date, 19 states and territories have issued bonds backed by their payments under the tobacco Master Settlement Agreement (MSA).* The average deal size of

$1.5 billion is large enough to allow institutional investors and broker/dealers to invest with some price transparency. With bellwether names offering yields roughly 4% greater than AAA -rated munis, some investors feel they are being compensated for the risk. We are not so sure.

Declining Consumption Presents a Risk

Larger-than-expected declines in tobacco use could be bad news for tobacco bondholders, as their payments are based on cigarette consumption and currently assume annual declines below 3%. But the rate of decline in cigarette shipments has been accelerating. Since the MSA was signed in 1998, the rate of decline has averaged 2.55%. In the past 10 years, however, the rate of decline was 3.16%. It was 4.55% over the past five years and 4.8% in 2013. Earlier bond deals were structured under the assumption that the rate of decline would average 1.8%; deals originated in 2007 used 2.9%. This has caused early bond deal cash flows to fall short of expectations, prompting draws on some reserve funds and defaults as early as 2023.

Investors are aware that consumption and, therefore, tobacco bond cash flows are declining. What makes tobacco-backed bonds unique is that the states will continue to receive payments, so even defaulted bonds will continue to receive a cash flow for years after their maturity date. Some investors model these cash flows and use an internal rate of return calculation to determine a discount rate and price level they are willing to accept for the presumably perpetual annual payment. But is it safe to assume that payments, while declining, will continue in perpetuity? Perhaps not, particularly given the headwinds to consumption.

Many factors negatively impact consumption, including price hikes, increases in state and federal excise taxes, less disposable income, smoking bans, packaging and marketing restrictions, and graphic warning labels, to name a few. But an even more substantial threat lies in the increasing popularity of electronic cigarettes (e-cigs).

The Significance of E-Cigs

Sales of e-cigs have grown from a few hundred million in 2010 to $2.2 billion in 2013. While scientific research into the safety of e-cigs is limited, the majority of the findings so far indicate they are significantly less harmful than combustible cigarettes. The FDA, in fact, has acknowledged e-cigs' potential as a less harmful alternative to smoking.

The big-three tobacco manufacturers have entered the e-cig market and are widely expected to dominate the category. Meanwhile, consumer acceptance of the product is also on the rise given both health and cost advantages. Disposable e-cigs cost 40% less than an equivalent number of combustible cigarettes, and vaporizers cost 90% less. Estimates around the timing vary, but most expect e-cigs could eventually replace combustible cigarettes.

E-cigs are not considered tobacco products under the MSA, so no payment is required to the states. Every cigarette replaced by an e-cig reduces the payments made to states under the MSA. As such, it would not be surprising if the cash flows under the MSA do not experience a steady decline (continuing in perpetuity), but rather, drop dramatically as e-cigarettes completely replace cigarettes.

What's an Investor to Do?

Tobacco bonds vary in credit quality, with ratings ranging from AAA to CCC. At BlackRock, we use a sophisticated model to run a series of cash flow scenarios, recognizing that each deal, and more specifically, each maturity within a deal, will perform differently under various stress levels. We believe this type of analysis is critical and, for that reason, we recommend investors relegate the work of navigating the tobacco sector to a professional money manager.

Strategy and Outlook

On balance, we favor states over locals and higher-yielding revenue sectors with strong credit fundamentals over GO bonds. In terms of quality preferences, we are biased toward the A-rated part of the credit spectrum and are using market strength to migrate up in quality.

High yield municipals have continued to capture a large share of investor assets this year and have outperformed the broader market. This reflects an investor reach for yield in a low-rate world and we would advise investors to be discerning in their choice of credits. We remain cautious toward those sectors that still face significant challenges, such as tobacco, lifecare and land-secured bonds.

Finally, overall market performance in 2014 has exceeded expectations, and that realization comes with an ounce of caution. The pace of gain is unlikely to continue unabated. This points to the importance of knowing what you own, and knowing what to avoid in the current investment climate.

Q3 MUNICIPAL CREDIT PREFERENCES

Places We Like…	Based on…	Places for Pause…	Based on…
• Intermountain West • Gulf Coast	Faster economic growth driven by lower costs, better business climates, favorable population trends	• Rust Belt	Urban municipalities with high legacy costs and deteriorating tax base
• Great Plains	Strong global demand for commodities	• Sun Belt	Exurbs exposed to boom/bust housing cycles
• Southeast • Midwest	Select areas benefiting from a resurgence in U.S. manufacturing	• Puerto Rico	Severe economic recession, high debt, population declines

Revenue Bonds	Look for	Avoid
Utilities	Providers that enjoy monopolistic status and rate-setting autonomy	Providers beset with aging infrastructure and regulatory pressures
Airports	Large-market hub locations with international exposure	Regional airports exposed to airline route realignment
Toll Roads	Established roadways with higher toll rates	Managed-lane models struggling to gain acceptance
Hospitals	National systems and regional providers operating in growing service areas with balance sheets able to handle potential changes in reimbursements under the ACA	Stand-alone providers located in markets with weak demographic characteristics and lacking financial flexibility
Education	Large public universities; private institutions with strong demand and significant endowments	Niche institutions overly reliant on tuition discounting to maintain demand

Aug 4, 2014
James Schwartz, CFA
Managing Director, Head of Municipal Credit Research

Timothy J. Milway, CFA
Director and Credit Research Analyst

PWC: Ten Key Points from the SEC's Final Money Market Rule.

No major surprises, but big open question After six years of debate over the risks and operations of money market funds (MMFs) – and events such as the fall of Lehman Brothers, breaking the buck at the Reserve Primary Fund, rancor between financial regulators, and hundreds of industry comment letters – the SEC finally adopted MMF reform on July 23rd. The final rule will fundamentally alter certain aspects of MMF operations and accounting, and the way these funds are viewed by investors.

The final rule combines approaches set forth in the SEC's proposal last summer to: (1) require institutional prime MMFs to float their Net Asset Values (NAV) and (2) provide tools to all MMF boards to discourage and prevent runs by investors through the use of redemption fees and gates. A key necessity for reaching the SEC's 3-2 vote in favor of the rule was the Treasury Department's and IRS's concurrent issuance of rules mitigating the tax compliance costs for institutional prime MMFs investors (whose investments will be subject to the floating NAV).

The clock is now ticking. MMFs have two years to implement the floating NAV and fees/gates requirements. MMFs also have 18 months to implement additional requirements for diversification, stress testing, disclosure, and reporting (Form PF and Form N-MFP), and nine months to implement requirements for reporting material events on a new Form N-CR.

Impact

1. Potential structural changes within the MMF industry. The floating NAV requirement may drive institutional prime MMF shareholders to move their cash to government MMFs or non-MMF alternatives that offer reasonable principal protection and slightly higher yield. This would likely cause industry repositioning as traditional sponsors – and new market entrants – innovate new products to meet investors' short-term cash management needs. Furthermore, institutional prime MMF advisers may decide that Rule 2a-7's risk-limiting provisions for MMFs are not worth the headaches without the stable NAV their funds have traditionally enjoyed.

2. Implementation challenges. MMFs and their sponsors will need to make necessary operational and compliance modifications to their systems and controls in order to implement floating NAV and fees/gates requirements by mid-2016. Two years may appear to be a long time, but in our view the challenges are significant (several comments on the proposed rule from key industry participants asserted that three years was a more reasonable implementation period). The SEC's Division of Investment Management has formed a working group to monitor the rule's impact and consider pragmatic solutions to assist with implementation challenges. There may be opportunities for engagement with SEC staff to work through these issues.

3. Will the reforms work? Until the next market crisis, it is difficult to know if the rule will achieve the objective of stabilizing MMFs, deterring investor runs, and preventing systemic ripple effects on other funds and financial asset prices – all without undermining the popularity of the $3 trillion industry among retail and individual investors. This is a clear concern of the industry who commented heavily on the proposal and of the regulators who made several changes to the proposed rule in response.

Key changes from the proposal

4. Reduced flexibility for government MMFs. Government funds remain exempt from floating their NAVs under the final rule, and can still opt into the gates and fees provisions if disclosed. However, the final rule defines a "government MMF" as one that invests at least 99.5% (increased from 80%) of its total assets in government securities, cash, or repos that are collateralized solely by government securities or cash. This significant decrease in the ability to invest in non-government securities will impact investment strategies and returns for these funds.

5. "Retail MMF" definition improved. Instead of distinguishing between retail and institutional MMFs based on maximum daily redemptions allowed (as proposed), a "retail MMF" will be one that has policies and procedures reasonably designed to limit its shareholders to natural persons. This change meets an industry request, but funds will still have to work with omnibus account holders (e.g., brokers and pension administrators) to make this definition workable.

6. More flexibility for MMF boards when imposing fees/gates. The SEC made three changes to the fees/gates proposal in order to address legitimate concerns from commenters that these tools could actually incentivize or exacerbate runs instead of prevent them:

The MMF board's discretion to implement redemption gates or liquidity fees (up to 2%) will kick in when weekly liquid assets fall below 30% (as opposed to 15% in proposal). The SEC views this change as making it more difficult for shareholders to out-guess and front-run the timing of board decisions.

A 1% default redemption fee would be required if weekly liquid assets fall below 10%, but the board would still have the ability to waive, increase, or decrease this fee upon determination of what fee (if any) is in the best interest of the MMF and its shareholders. The default rate changed from 2% to 1% as requested by many commenters.

The maximum gate period is 10 business days in any 90 calendar day period (instead of 30 business days as proposed). The hope is that this shorter gate will reduce run incentives.

7. Amortized cost accounting remains for retail and government funds. NAV calculations and transaction processing based on amortized cost accounting will still be allowed for MMFs other than institutional prime MMFs (the proposal would have done away with amortized cost accounting for all MMFs). This will allow intra-day NAV calculations and settlements, thus permitting retail and government MMFs to continue offering desirable features like check writing and ATM withdrawals. However, because all MMFs will still be required to post daily market-based NAVs on their websites, even retail and government funds will have to invest in additional operational/systems resources. The SEC also maintained the required basis-point rounding for all market-based NAV calculations (i.e., four decimal places for $1 NAV MMFs).

8. Refined stress testing. A key focus of required stress testing will now be on the MMF's ability to maintain weekly liquid assets of at least 10%, consistent with the new redemption fee threshold.

9. Modest relief for municipal MMFs. While municipal MMFs did not receive the industry's desired blanket-exemption from the floating NAV requirement, the SEC did give some diversification relief to these funds. The final rule allows municipal MMFs to concentrate up to 15% of their assets subject to guarantees or demand features from one entity (the proposal would have limited this to a maximum of 10% for each entity).

What's next?

10. SEC to share the spotlight with industry, investors, and … FSOC (again). MMF advisers and other service providers will begin assessing the rule's major impacts on systems, reporting, technology, and board communications. Meanwhile, investors – especially institutional investors – will evaluate the desirability of MMFs as their default home for short-term cash. Finally, the Financial Stability Oversight Council (FSOC), which has long been vocal on the need for MMF reform, will be weighing in on the sufficiency of the SEC's new reforms and providing clues as to whether the rule will impact its next steps for designating certain asset managers as systemically important.

MMA Municipal Issuer Brief - Issuer Disclosure

Read the Brief.

PennDOT Takes on P3S as States Cope with P3 Complexity.

The Pittsburgh Post-Gazette concluded a four-part report discussing P3s in Pennsylvania and across the country Wednesday with in-depth coverage of Pennsylvania's current P3 projects and an examination of the common anxieties governments and the public have about P3s.

Part three of the paper's series describes PennDOT's rapid bridge replacement program, efforts to implement P3s along Pennsylvania waterways, and details on the state's P3 law.

The rapid bridge replacement program will allow a single company to take on hundreds of bridge replacements across the state, streamlining much of the design and manufacturing processes to save taxpayer money.

Pennsylvania's recently passed P3 law allows the state's Public Private Transportation Partnership Board to oversee the projects and allows the legislature to veto some projects involving state-owned facilities. The effort Pennsylvania put into its P3 law is evident, Steve Park, an attorney for Ballard Spahr in Philadelphia, told the Post-Gazette.

"It allows for flexibility for PennDOT, but there's also a good measure of safeguarding to protect the public interest," Park said.

In the conclusion to the four-part series, the Post-Gazette argues P3s are poor policy, fraught with hazard for governments ill-equipped to oversee complex P3 contracts. Further, businesses looking to partner with the government often overestimate the profit stream P3s will generate, leading to financial difficulty after project completion.

The story cites academic research, government officials, lawyers and public advocates all roundly dismissing P3s as an acceptable option for state governments.

Aug. 10: The ‘P3’ dilemma: How effective are public-private partnerships

Aug. 11: The ‘P3’ dilemma: Partnerships often fall short of taxpayers’ expectations

Aug 12: The ‘P3’ dilemma: Pennsylvania is moving ahead with P3 plans

Aug. 13 The ‘P3’ dilemma: States learn partnerships come with hazards

NCPPP
By Editor August 14, 2014

Flagstaff Funds Wildfire Prevention with Bonds.

The Arizona city is likely the only in the country to pay for wildfire prevention with bond money and is being looked to as a national model for leveraging federal funds.

The cash-strapped U.S. Forest Service is way behind in treating its lands to prevent wildfires. So Flagstaff, a northern Arizona city that sits in the middle of a national forest and sees 300 fires a year, is paying for treatment on nearby federal lands itself.

The city is spending $10 million to thin 15,000 acres of forest in an effort to make Flagstaff more resilient in the face of bigger forest fires, floods, violent storms and temperature extremes. The money is coming from city bonds funded by a property tax hike approved two years ago.

Work on state-owned land has already started, but the biggest share of the effort, in the Coconino National Forest, could start as soon as next spring.

It is, as far as Flagstaff leaders can tell, the only city in the country tapping bond money for wildfire prevention. A handful of other cities, such as Denver, Santa Fe, N.M. and Ashland, Ore., have paid for similar efforts with other funding sources.

“We could just continue to pound on our congressman and senators and the Forest Service” for more federal money to fund the treatment, said Paul Summerfelt, the Flagstaff fire department’s wildland fire management officer. “The end result of that is just a lot of yelling and screaming and not a lot gets done … There’s not enough money in the Treasury for the work that needs to be done.”

Instead, the city has worked for nearly two decades to try to mitigate the damage of nearby fires. “When all of this began to emerge, there was a paradigm in the community that every tree was good, every fire was bad and we needed to save everything,” Summerfelt said.

But the city government, with the fire department taking the lead, showed residents the benefits of forest management by treating woods and using controlled burns, mostly on private lands. Researchers at Northern Arizona University, which is in Flagstaff, helped educate the public, too. The city adopted a new fire code to address the threat of wildfires specifically . In 2006, residents saw how a fire that raged in untreated forests quieted when it reached treated areas.

The difference is most easily seen after fires are put out, Summerfelt said. Untreated areas are black; treated areas are still green. “It goes from a crown fire with 150-foot flames above the crowns of the trees down to a ground fire, where it’s 3 or 4 feet off the ground and we can deal with it,” he said. Often, residents can return to their homes the evening after a fire enters a treated area.

By the time the bond question went before Flagstaff residents in 2012, it passed with 74 percent of the vote.

Since Flagstaff agreed to pay for the project out of its own pockets, the city has attracted another $1.6 million in grants. Most of that has come from the U.S. Forest Service, because the agency is interested in using the project as a model for how to leverage federal funds in other areas, Summerfelt said.

The effort comes as wildfires have become more common and costly. The years that have seen the most widespread fire damage, in terms of total acres burned, have all occurred since 2004. Three of those years — 2006, 2007 and 2012 — saw more than 9 million acres burned, roughly the size of Massachusetts and Connecticut combined. The costs of putting out the fires are also mounting. The annual bill for fire suppression nationwide topped $1.7 billion in each of the last three years.

Experts say the fires are becoming more dangerous because of global warming, a build-up of fuel in forests and the encroachment of development into forested areas.

Flagstaff itself has seen increasingly volatile weather, said city manager Kevin Burke. The city, with an elevation of 7,000 feet, has endured brutal snowstorms, searing heat and even tornadoes in recent years.

But the main threat comes from forest fires and the flooding that often follows those fires. Flagstaff's treatment plan focuses on two areas near town where that flooding would be especially dangerous.

The first is the Dry Lake Hills area north of town, and adjacent to a swath of land that burned four years ago. High winds burned 15,000 acres in the 2010 Schultz wildfire, which forced 1,000 residents from their houses and stripped the slopes of the San Francisco Peaks. When torrential rains came four weeks later, rivers of dark water washed out roads, broke water lines and killed a 12-year-old girl in a flash flood.

But the consequences would be even worse, if a large fire broke out in the Dry Lake Hills, city officials said, because it would pose a greater threat to downtown and the campus of Northern Arizona University.

The second area targeted for treatment is near Lake Mary, south of Flagstaff, which supplies half of the city's water. Floodwaters filled with soot and sediment could render the city's water treatment plant on the lake useless. To make up for the lost water, the city would have to drill 11 new wells at the cost of $2 million apiece.

Without city action, the selected areas are unlikely to attract interest from private companies that bid on forest management projects, said Burke. Some of the areas are so steep that cables or helicopters would be needed to remove logs. Other parts are populated by trees that are too thin to make good lumber.

GOVERNING.COM
BY DANIEL C. VOCK | AUGUST 11, 2014

[GASB: Auditor Survey on the Effectiveness of Statement 34.]()

The Governmental Accounting Standards Board (GASB) is currently conducting pre-agenda research to inform its assessment of the effectiveness of Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and related standards. The objective of this research is to gather feedback on these broad questions:

- What financial reporting model requirements related to management's discussion and analysis, government-wide financial statements, fund financial statements, and budgetary comparison information are effective or ineffective in providing information that is essential for decision-making and that enhances the ability to assess a government's accountability?
- What concerns exist regarding the application of the standards?
- How do the costs of applying the standards compare with the perceptions of the benefits of the resulting information?

The GASB has developed an online survey to gather feedback from auditors of governmental financial statements. The GASB would greatly appreciate you taking the time to complete the auditor survey, which can be accessed here.

It is anticipated that the survey will take longer than a typical GASB survey, given the magnitude of the requirements in Statement 34. You can, however, download a copy of the survey in its entirety to consider before entering your responses into the online version. The deadline for completing the survey is Friday, August 15, 2014.

Your input is vital to the GASB's standards-setting process. If you have any questions, please feel free to contact Roberta Reese (rereese@gasb.org) or Lisa Parker (lrparker@gasb.org).

Pension Disputes Raise Transparency Questions for Advisors, Investors.

Financial advisors with tax-free municipal bond funds in their client portfolios may want to reconsider investing in those securities in the wake of the settlement of fraud charges leveled against the state of Kansas.

Federal regulators with the Securities and Exchange Commission (SEC) announced that they had settled with Kansas over misleading investors about the financial health of its public employee pension system in 2009 and 2010.

It is the third settlement with the states in the past four years. Illinois settled last year and New Jersey in 2010.

The repercussions of the underreporting and nondisclosure surrounding pension liabilities mean that retail and institutional financial advisors, fund managers and investors are exposed to risks they don't know about.

SEC regulators said Kansas had accepted the settlement offer "without admitting or denying the findings."

LeeAnn Ghazil Gaunt, chief of the SEC Enforcement Division's Municipal Securities and Public Pensions Unit, said that inadequate disclosure of the state's multibillion-dollar pension liability had left investors with an "incomplete picture of the state's finances and its ability to repay the bonds."

Gov. Sam Brownback said that his administration has adopted policies to disclose pension liabilities in bond offerings.

The Kansas settlement represents the latest attempt by the SEC to bring more clarity and transparency to the $3.7 trillion municipal securities market.

Relatively opaque and loosely regulated compared to the U.S. Treasury market, the municipal market is crying out for more transparency and reform, according to critics and watchdogs.

Over the past several months, the SEC has also brought charges against regional improvement districts and authorities as regulators seek to impose tighter reporting standards and better disclosure among municipal market participants.

Last year, the ratings agency Moody's Investors Service said it would implement changes to the way it analyzes and adjusts pension liabilities as part of its credit analysis of local and state governments.

Moody's Managing Director Timothy Blake said the changes would provide more "transparency and comparability in pension liability measure for use in credit analysis."

Pension obligations "represent a growing source of budgetary pressure for many governments," Blake said.

The ways in which the pension obligations are reported varies widely, "and we believe liabilities are underreported from a balance sheet perspective," he added.

While the majority of municipal obligations are manageable, pension funding has declined since 2000, when liabilities started to grow faster than assets, according to a study by the Pew Charitable Trusts.

In the SEC's latest case involving Kansas, investigators said that from August 2009 through July 2010, the Kansas Development Financial Authority raised $273 million through eight series of bonds without disclosing the existence of unfunded liabilities in the Kansas pension system.

Kansas Public Employees Retirement System, or KPERS, manages defined benefit plans for about 1,400 public employers in Kansas, of which the state is the largest employer. KPERS had an unfunded liability of $7.7 billion by the end of 2009.

That made KPERS the second-most underfunded statewide public pension system in the nation after Illinois, according to an analysis by the Pew Center on the States.

SEC investors said that from 2004 to 2009, on the advice of outside accounts, the state changed the way KPERS' pension liabilities were reported in the state's annual financial report.

During the five-year period, state financial reports "made no reference to the state's substantially underfunded pension plan," even as other states around the country were disclosing similar information, the SEC said.

Similar settlements between the SEC and Illinois last March, and New Jersey in August 2010, involved much larger numbers.

SEC investigators said that in connection with multiple bond offerings raising more than $2.2 billion from 2005 to 2009, the state of Illinois mislead bond investors not only about the adequacy of its pension funding, but about changes to the pension funding plans which include lower pension contributions, as well.

The SEC also said that revealing the "structural underfunding " of the Illinois pension system to investors would have offered investors a more accurate picture of the state's financial condition and it's future financial prospects.

As of fiscal year 2012, unfunded public pension liabilities were as high as $94.5 billion, and the funded ratio was only 40 percent according to the Pew Charitable Trusts.

In the case of New Jersey, the SEC said the state misrepresented and "failed to disclose material information" regarding the underfunding of the Teachers' Pension and Annuity Fund and the Public Employees' Retirement System.

The misrepresentations were in connection with the sale of more than $26 billion in municipal bonds from August 2001 to April 2007, the SEC said.

International Travel Means Big Opportunities for Producers this Summer.

Pew lists New Jersey with a fiscal year 2012 unfunded public pension liability of $47.2 billion and a funding ratio of 65 percent.

By Cyril Tuohy
InsuranceNewsNet

Cyril Tuohy is a writer based in Pennsylvania. He has covered the financial services industry for more than 15 years. Cyril may be reached at cyril.tuohy@innfeedback.com.

Congress Considers Reviving Risky Bonds to Boost Small Businesses.

Industrial development bonds historically have the highest default rate, but a bill in Congress would revamp them.

IDBs are the bad boys of the muni market. The less-than-stellar reputation comes because industrial development bonds, as they are otherwise known, default more than almost any other municipal bond. General obligation bonds, for instance, hardly ever default. Revenue bonds default only slightly more often. But IDBs account for 28 percent of all municipal bond defaults.

Perhaps it's because of this and the Great Recession that IDBs are no longer a favored economic development tool for state and local governments. Initially offered to help small, local companies find comparatively inexpensive financing to create jobs, IDB issuance is down by 70 percent, or roughly $700 million, from its peak in 2007.

Jason Rittenberg, director of research and advisory services at the Council of Development Finance Agencies (CDFA), thinks he knows what's holding IDBs back. I recently talked to him about the future of IDBs and about a bill in Congress to revive them.

Beyond the recession's effect, what do you see as the problem with IDBs?

One big reason for the decline in issuance of IDBs is that the portion of the revenue code [it's contained in] has not seen a significant revision since 1986. We at CDFA believe that if the code were updated to reflect the larger size of small manufacturers today, as well as the types of facilities manufacturers need to be effective, we would see more use of IDBs. For instance, a change in the code would make it easier for high-tech firms to have research facilities included as part of bond issuance. And seeing more use is important because low-cost capital helps small manufacturers grow and create more high-quality, high-paying jobs. Depending on the company, they might be able to get lower than traditional cost financing. As lending rates increase, this will be much more affordable.

IDBS usually come to market without a credit rating and without insurance. They have a relatively high rate of default. Is that a problem? Should legislation do anything to make them safer?

They are a higher risk asset than some other muni bonds. A general obligation bond is backed by the general revenue of a municipality so they have low default rates. But IDBs and other private activity bonds have higher yields. They're a worthwhile investment for those interested. This bill is not going to address that, but it is not going to make it more of a concern. IDBs are an asset that should be looked at by sophisticated investors. Unrated debt is generally understood to be a higher risk than rated debt and therefore produces higher yields for the investors. Often, it is secured by a credit enhancement [that is sometimes rated] and therefore a default does not necessarily preclude repayment to the investor.

Given the temperament of this Congress and its inability to pass almost any legislation, what sort of chance do you think the Modernizing American Manufacturing Bonds Act has? Is there a danger in it skirting dangerously close to tax reform that might set limits on muni bond issuance?

It's difficult to predict the success of this bill, but it has bipartisan support. It is looking at modernizing the code, not creating a new vehicle.

Is it skirting close to looking at the muni market? A better way to look at it is not as tax reform or as a muni bond issue, but as an issue in creating jobs. If you look at the merits of what the country is trying to do with the national economy, this bill would be seen as effective and be passed. This is a vehicle that issuing authorities can use to support businesses in communities, especially companies that feed into the supply chain of major manufacturers, such as auto plants and airplanes. These smaller manufacturers are a huge job creation machine. Local officials want to support those smaller manufacturers in their communities. A lot of times these bonds are going to companies with a handful of employees; the capital is used to grow them into the next level. It's economic gardening. It isn't money going to speculative startups, but to small companies that have a track record.

GOVERNING.COM
BY PENELOPE LEMOV | AUGUST 14, 2014

Tobacco Settlement Bonds: The Next Cloud on the Horizon for Municipal Bonds?

As the young gas station attendant says at the end of the movie Terminator "there is a storm coming." While Detroit and Puerto Rico's financial struggles continue to rattle the municipal bond market, the over $87 billion state issued tobacco settlement bond market is another potential dark cloud worthy of watching.

A recent article in the Huffington Post 'How Wall Street Tobacco Deals Left States With Billions of Toxic Debt' initiates an important discussion on the future of the future of this large sector of bonds. The S&P Municipal Bond Tobacco Index has returned over 10.6% year to date as it leads all other municipal bond sectors in performance. These impressive short term gains mask the risk associated with these bonds. Two of the largest risks are that the average credit quality of bonds in this sector is well below investment grade and the heavy issuance of zero coupon bonds creates a sector that has one of the longest durations in the municipal bond market.

Why worry now? The hazardous combination of credit and interest rate risk. Repayment of these bonds is heavily dependent upon sales of tobacco products in the U.S. at a time when U.S. tobacco consumption is declining. The long duration of bonds in this sector make it highly vulnerable to when interest rates begin to rise – the prices of these bonds will fall more quickly and by a larger amount when interest rates begin to rise.

Select Municipal Bond Index Yields and Returns:

Index Name	YTW	YTD Returns
S&P Municipal Bond Index	2.54%	6.67 % ▲
S&P Municipal Bond Investment Grade Index	2.20%	6.49 % ▲
S&P Municipal Bond High Yield Index	6.53%	9.31 % ▲
S&P Municipal Bond Tobacco Index	6.18%	10.69 % ▲
S&P Municipal Bond Puerto Rico Index	7.84%	4.82 % ▲

Source: S&P Dow Jones Indices, LLC. Data as of August 7, 2014.

Seeking Alpha
Aug. 11, 2014 8:13 AM ET
By J.R. Rieger

S&P Widens Lead Over Moody's as Bond Upgrades Surge: Muni Credit.

Standard & Poor's is pulling away from Moody's Investors Service in the business of grading U.S. municipal bonds. Janney Montgomery Scott LLC's Tom Kozlik says the gains reflect local governments shopping for the best ratings.

Of the $164 billion of long-term, fixed-rate debt issued this year through July, about 86 percent carried an S&P grade, while 74 percent used Moody's, data compiled by Bloomberg show. The difference of 12 percentage points is the biggest since at least 2007 and up from 5 percentage points in 2011 and 2012. S&P says its market share ranged from 86 percent to 91 percent in the six years through 2013.

A new methodology that S&P began implementing last year to assess localities will elevate more credits than it lowers, the New York-based company has said. While Moody's cut more muni ratings than it lifted in the first half of the year — a trend that has held for 22 quarters — S&P says it upgraded 1,255 public-finance issuers and reduced 410. The six-month tally of S&P upgrades compares with 1,415 in all of 2013 and 543 in 2012.

"This differentiation in S&P and Moody's should be problematic to investors who are counting on these ratings and trading oftentimes based only on the ratings," Kozlik, a municipal credit analyst at Janney in Philadelphia, said in a telephone interview.

"Issuers' actions to not include Moody's anymore are oftentimes because Moody's is a notch or two or three lower," said Kozlik, who published a report last month titled "Are S&P's Local Government Ratings Too High?"

Conflicting View

Investors in the $3.7 trillion municipal market rely on the two biggest rating companies, both of which trace their roots back more than a century, to satisfy mandates requiring they buy bonds rated above specified levels. Yet they're skeptical because of outsize ratings changes on issuers as large as Puerto Rico and as small as Vadnais Heights, Minnesota. Both have faced single downgrades of three or more levels.

Investors' view of the companies is further muddied by the industry's reigning business model, in which issuers pay for credit grades and can choose among ratings. Dallas-Fort Worth International Airport and Chicago Park District are among borrowers that dropped ratings in the past year from Moody's. The airport is graded one step lower by Moody's than S&P, and the Chicago district five steps lower.

'Careful' Approach

In June, 11 issuers published only an S&P rating even though they also had Moody's grades, according to Kozlik. The S&P rating was higher in every case.

"Whether someone decides to use one rating or another, we don't control that," said Jeff Previdi, one of the primary analysts on the criteria change for S&P, a unit of McGraw Hill Financial Inc. (MHFI) "What we do control is our analytics. We're going to be measured on our opinions as to how they perform over time, so you can be certain that we're going to be very careful and informed."

Thomas Lemmon, a Moody's spokesman, declined to comment on market share or the decisions of specific issuers. For this year through July, the company's market share in munis is the lowest in Bloomberg data starting in 2008.

S&P, the world's largest credit grader by outstanding ratings, and its peers drew scrutiny after they helped fuel a global housing bubble by awarding top scores to subprime mortgage investments.

Ratings Campaign

McGraw Hill and S&P face a Justice Department lawsuit, filed in February 2013, which alleges S&P deliberately understated the risk of securities backed by residential loans. S&P has said it will defend itself "vigorously" against the "meritless" claims.

Moody's, S&P and Fitch Ratings in 2011 also settled claims by Connecticut that they unfairly gave lower grades to public bonds, leading the state, municipalities and school districts to pay higher interest rates than they should have.

That followed a campaign in 2008 by muni issuers led by California Treasurer Bill Lockyer for raters to elevate grades on states and localities. Moody's and Fitch recalibrated their muni ratings in 2010 to a global scale.

When S&P finishes applying its new criteria for local governments, it estimates that 30 percent of the more than 4,000 issuers will have higher grades. Previdi said the company first focused on municipalities most likely to have their ratings changed, which helps explain the pace of this year's upgrades. A recovering economy has also contributed to the increase, he said.

Share Range

"Over the past several years our market share has generally been in the mid-to-high 80 percent range," Ed Sweeney, an S&P spokesman, said in an e-mailed statement. "We haven't seen a significant divergence from that trend following the criteria change."

S&P has an 89 percent market share this year through July, the highest since 2010, according to Sweeney.

The new methodology involves scoring a municipality on a scale of 1 to 5, with 1 being the strongest, on areas including the economy, management and budgetary performance.

"The problem with changing their criteria is it materially impacts ratings sometimes," even when issuers' fiscal health is unchanged, said Lyle Fitterer, who oversees $34 billion of munis at Wells Capital Management in Menomonee Falls, Wisconsin. "If a bond is rated, you have to use the ratings that are out there. It does impact your willingness to own it or buy more of it."

Makes Sense

Having multiple rating companies offers states and cities opportunities to seek higher grades to lower borrowing costs, which "makes all the sense in the world," Kozlik said.

Dallas's largest airport stopped getting a Moody's rating this year, said Michael Phemister, the facility's vice president of treasury management. It paid Moody's about $500,000 to rate its 2013 bond deals, compared with ranges of about $350,000 to $400,000 for S&P and Fitch, he said.

Moody's didn't give enough credit to the region around the airport, Phemister said. The company also cut its debt in March 2013 to A2, one level lower than S&P's A+ and two steps below the AA- assigned by Kroll Bond Rating Agency Inc. this year. The company began grading muni issuers two years ago.

The Chicago Park District, Chicago Transit Authority and the Wisconsin Department of Transportation have also turned to Kroll for ratings, all of which are higher than Moody's.

"That's the curse of a new rating agency," Jim Nadler, president of Kroll in New York, said in a telephone interview. "No one is going to add a fourth rating that is lower. You'll never see the ones that we turn away or gave lower ratings to."

Fee Factor

Moody's, for its part, is also seeing the ratio of downgrades to upgrades improve as the economy rebounds, said Naomi Richman, an analyst in New York. The company revised its outlook on local governments to stable from negative in December. In June, it raised ratings on California and New York, which combined have more than $148 billion in debt.

Fees can also play a role in choosing a ratings company. Wisconsin's $587 million general-obligation deal last year had ratings from Moody's, S&P, Fitch and Kroll, according to David Erdman, the state's assistant capital finance director. It paid the firms $100,000, $76,000, $55,000 and $50,000, respectively.

Revenue matters even more now in the muni business than in the past few years because states and cities are selling less debt, leaving the market poised to contract for a record fourth straight year.

Kozlik concludes that ratings shopping will probably continue, with municipalities choosing S&P even though Moody's grades better reflect localities' fiscal vulnerability.

That could cause investors — particularly individuals — to lose out on extra yield because of the higher grades at a time when interest rates are close to generational lows.

"When I see ratings shopping going on, I think about those small investors who are relying solely on the ratings," Kozlik said. "S&P's new criteria for local governments is just increasing that differentiation."

By Brian Chappatta Aug 11, 2014 7:21 AM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Alan Goldstein at agoldstein5@bloomberg.net; Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum

---

Kansas Issuer Credit Rating Lowered to 'AA' From 'AA+' on Structurally Unbalanced Budget; Outlook Negative.

NEW YORK (Standard & Poor's) Aug. 6, 2014–Standard & Poor's Ratings Services lowered its issuer credit rating (ICR) on the State of Kansas to 'AA' from 'AA+'. At the same time, Standard & Poor's downgraded Kansas' annual appropriation-secured debt to 'AA-' from 'AA'. The outlook on both ratings is negative.

"The downgrades reflect our view of a structurally unbalanced budget, following state income tax cuts that have not been matched with offsetting ongoing expenditure cuts in the fiscal 2015 budget," said Standard & Poor's credit analyst David Hitchcock. In our opinion, recent shortfalls in income taxes will leave both fiscal years 2014 and 2015 with ending general fund balances much less than projected in the enacted fiscal 2015 budget.

"The negative outlook reflects our belief that there will be additional budget pressure as income tax cuts scheduled in future years go into effect, or if midyear revenue shortfalls resume, although the state recently announced a small positive revenue variance for July," Mr. Hitchcock added. We believe the state could easily face a negative general fund balance in fiscal 2015 should even relatively small negative revenue variances resume, absent midyear corrective action

The 'AA' ICR reflects our opinion of Kansas':

- Economy, which has generally moved in line with the nation but with lower-than-average unemployment, despite a below-average demographic profile and concentration in the manufacturing industry;
- Recently strong general fund balance position that is being drawn down to what we believe could be low levels at the end of fiscal 2015;
- Governmental framework, which we consider strong; and
- Ability to support cash flow needs through the use of interfund certificates of indebtedness and manage disbursements between fiscal years to preserve liquidity even during prior periods of low fund balances.

Offsetting credit factors for the ICR include what we consider Kansas':

- Likely need for future expenditure cuts to offset enacted cuts in income
- tax rates in future years; and
- Significant unfunded pension liabilities that offset, in part, the state's moderate tax-supported debt burden.

The lower rating on the appropriation-secured bonds reflects debt service payments that are subject to annual state appropriation.

The negative outlook on the ICR reflects what we view as the potential for greater structural budget imbalance in the next two years. Should the general fund fall into a significant structural budget imbalance, potentially as a result of a substantial negative general fund balance developing in mid-fiscal 2015, or a significant mismatch between revenues and expenditures in fiscal 2016 as further income tax rate cuts go into effect, we could lower the rating. Should revenues come in close to budget in fiscal 2015, and the state takes action toward structural budget alignment in fiscal 2016 to offset potential revenue losses from income tax rate cuts, we could revise the outlook to stable.

The negative outlook on the state's appropriation-secured debt reflects the negative outlook on the Kansas ICR.

RELATED CRITERIA AND RESEARCH

Related Criteria
USPF Criteria: State Ratings Methodology, Jan. 3, 2011
USPF Criteria: State Credit Enhancement Programs, Nov. 13, 2008
USPF Criteria: Financial Management Assessment, June 27, 2006
Related Research

U.S. State And Local Government Credit Conditions Forecast, July 8, 2014
Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Primary Credit Analyst: David G Hitchcock, New York (1) 212-438-2022;
david.hitchcock@standardandpoors.com

Secondary Contact: Henry W Henderson, Boston (1) 617-530-8314;
henry.henderson@standardandpoors.com

S&P: It's Complicated . . . The Relationship Between Illinois' Credit Rating and the Ratings of its Public Universities.

Illinois' budgetary performance, a growing unfunded pension liability, and legislative inaction are all well documented. Since 2008, Standard & Poor's Ratings Services has lowered its rating on Illinois four times The credit quality of government-related entities, such as public universities, is affected by their relative state's support to varying degrees. Illinois' pattern of credit deterioration over the past several years has, more recently, negatively affected the credit ratings on the state's higher education institutions. Although the recent change in the state's outlook to negative doesn't necessarily equate to a change in each university's outlook, since state appropriations make up 42% of these institutions' revenue on average, there are negative implications.

On July 23, 2014, Standard & Poor's revised its outlook on Illinois to negative from developing and affirmed the 'A-' rating on the state's GO bonds. The outlook revision follows the enactment of Illinois' fiscal 2015 budget, which in our view is not structurally balanced and will contribute to growing deficits and payables that will likely pressure the state's liquidity. The outlook also reflects the implementation risk associated with recent reforms related to postretirement benefits. While we consider legislation to reform pensions and other postemployment benefits (OPEB) to be positive, if the reforms do not move forward as planned, we believe the significant fixed costs associated with postretirement benefits will escalate. Highlighting this risk is the recent Illinois Supreme Court decision to reverse the trial court's dismissal of the suit relating to statutory changes to the state's health insurance premium subsidies, which was remanded back to the lower courts. What the lower court will ultimately decide is uncertain, but the Illinois Supreme Court was clear in its opinion that the health insurance subsidies the state pays for retiree health care are a benefit derived from membership in a state pension plan and are, therefore, subject to the Illinois Constitution.

Read the full Report.

Americans Oppose P3S to Upgrade Transportation Infrastructure.

Americans strongly support investing in infrastructure, but oppose raising taxes or having private companies fund infrastructure improvements, according to a new poll conducted by the Associated Press and GfK.

Survey respondents opposed reliance on public-private partnerships to build new toll roads and bridges by a 2 to 1 margin. Only 14 percent of Americans support raising the gas tax, which is currently how the federal government funds highway and transit projects across the country. Fifty-eight percent of Americans oppose raising the tax.

Despite the public's reluctance to pay for new infrastructure, a majority of Americans think a robust highway system benefits the economy; for drivers who get in the car multiple times per week, 62 percent think the benefit of improved roads outweighs the cost.

"No one should be surprised by a poll finding people aren't willing to pay more for something they're already getting at a big discount," Brian McGuire, president of Associated Equipment Distributors told the Washington Post. "My read is that Americans understand the benefits of infrastructure but don't understand how it's paid for. We can either do that the responsible way — raising the gas tax or creating other new user-fee revenues — or we can continue to pass the buck to our kids and grandkids."

While the survey respondents did not want to pay for new roads, 56 percent agreed that traffic has gotten worse in the last five years in their community. Six percent found traffic had improved, and 33 percent said that it's stayed about the same.

NCPPP
By Editor August 7, 2014

Chicago Infrastructure Trust Still Teasing with PACE.

What Mayor Rahm Emanuel once hailed as an innovative conduit to more than $1 billion in private-sector dollars for public works projects has evolved into a low-budget broker of new ideas and interagency cooperation.

Since the Chicago Infrastructure Trust was announced in early 2012, with former President Bill Clinton at the mayor's side, only one $13 million project is underway—retrofitting city buildings to save energy. Trust CEO Stephen Beitler, a former private-equity executive, says he is close to a deal to finance roughly $50 million in energy-saving upgrades at 141 city swimming pools and is working on financing a $27 million upgrade of wireless service for the Chicago Transit Authority.

Yet Mr. Beitler manages to keep expectations high by touting a $1.5 billion pipeline of potential deals, including a voluntary property tax assessment of commercial properties to pay for energy-related improvements. The trust is evaluating a dozen proposals totaling about $1 billion from 15 firms for the Property Assessed Clean Energy program, although not all those Pace bids will be accepted, he adds.

The trust's slow progress is the result of several factors, including the novelty of a middleman trying to bring together City Hall and investment firms. Despite its hype, the trust is a small venture, financed with an estimated $1.5 million in city funds over its first two years (see the PDF). And the deals are difficult to do, with Mr. Beitler discarding more than a dozen proposals.

While the cash-strapped city's need for "transformative" improvements in transportation and other infrastructure has not gone away, the trust has suffered from overly ambitious predictions.

"When the trust was set up there were certainly some high expectations set up for it," says Peter Skosey, an expert on infrastructure finance and executive vice president of the Chicago-based Metropolitan Planning Council, where the trust's board holds its meetings. "Many of those expectations weren't warranted."

After Mr. Emanuel announced plans for the trust in March 2013, it took almost a year just to appoint a board of directors, create a charter, approve bylaws and hire Mr. Beitler.

Mr. Beitler now distances himself from the earlier, lofty predictions, saying, "I wasn't present when the expectations were set."

Although Mr. Clinton called the trust an “infrastructure bank,” it doesn’t have a pool of money to invest. Instead, Mr. Beitler, one of the trust’s two full-time employees, must painstakingly assemble complicated financing deals.

“The market’s the market, unless they have millions and millions of dollars to give out,” says Steve Steckler, chairman of Bethesda, Maryland-based Infrastructure Management Group Inc., a consulting firm that values public assets.

Mr. Beitler says he is pleased with the progress of the trust, which has about 20 deals in the works. “That’s an outstanding growth rate for an organization like ours,” he says. “You can’t get it done in a day.”

The Pace program could be the trust’s most ambitious plan. Commercial landlords must agree to a special property tax used to pay the upfront cost of energy-efficiency improvements. The idea is that energy savings would exceed the added tax. Because it is structured as a tax, the landlord can pass the cost on to tenants.

‘DEFINITE OPPORTUNITIES’

Pace financing is used in some other cities, with nearly $83 million in funding approved for 261 projects, according to PaceNow, a Pleasantville, New York-based nonprofit that promotes the concept.

“There are some definite opportunities with Pace funding for certain buildings that might not like other kinds of financing,” says Ron Tabaczynski, director of government affairs at the Building Owners and Managers Association of Chicago, which represents large downtown office buildings. “But I don’t know how many buildings will be looking to increase their property taxes at this point in time, given the uncertainty about where property taxes are going in light of pension issues.”

Acceptance by lenders, who must approve Pace deals, also is uncertain because the Pace assessment has priority over mortgage payments. The Federal Housing Finance Agency, which regulates residential lenders Fannie Mae and Freddie Mac, does not allow Pace financing.

Mr. Beitler says Pace could finance energy-saving improvements on city-owned structures, although he acknowledges he doesn’t have a “clear, final answer” on how.
If it can’t, Pace seemingly would divert the trust away from its core mission of financing public works projects. But Mr. Beitler says it’s a route worth pursuing.
“It reduces the cost of doing business in Chicago,” he says. “It seems to me this is a transformative infrastructure project. To get a bunch of different city, county and state agencies to work together is not a small task.”

Crain’s Chicago Business
By Paul Merrion August 04, 2014

[MMA Municipal Issuer Brief - Infrastructure Finance.]

[Read the Brief.]

Congress Introduces Modernizing American Manufacturing Bonds Act.

The Modernizing American Manufacturing Bonds Act is a comprehensive reform package that will modernize and revolutionize Qualified Small Issue Manufacturing Bonds, more commonly known as Industrial Development Bonds (IDBs) or simply manufacturing bonds. Manufacturing bonds are a type of Private Activity Bond (PAB) that allow the public sector to pass considerable interest rate reductions on to private companies through the issuance of tax-exempt bonds.

This bedrock tools is the single most actively used bond tool for financing the small- to mid-sized manufacturing sector and are a key economic development tool for state and local economic development agencies. The four reforms will expand the capacity and usability of manufacturing bonds to help create American jobs immediately. The four reforms are as follows:

1. Expand the Definition of Manufacturing to Include both Tangible and Intangible Manufacturing Production for Manufacturing Bonds

2. Eliminate the Restrictions on “Functionally Related and Subordinate Facilities” for Manufacturing Bonds

3. Increase the Maximum Bond Size Limitation from $10M to $30M for Manufacturing Bonds

4. Increase the Capital Expenditure Limitation from $20M to $40M for Manufacturing Bonds

---

'Pay for Success': a Better Way to Deliver Social Services?

The idea of shifting the risk of failed initiatives from taxpayers to investors is catching on.

Nobody likes to pay taxes, but I suspect that most people would find it a little easier to take if they knew their tax dollars were funding the achievement of concrete public goals. That’s the idea behind “pay-for-success” programs that have been launched during the last year in Illinois, Massachusetts and New York state and are being developed or considered in several others.

Under these programs, government sets out a set of specific goals in areas such as mental illness, homelessness or preventive health care. Private investors and philanthropic organizations then finance the work of nonprofits to deliver cost-effective, evidence-based social services on behalf of the state. The investors receive “success payments” only if the desired results are achieved.

Last December, New York became the first state to launch a pay-for-success program. There the goal was to reduce recidivism among 2,000 recently released prison inmates. Bank of America and Merrill Lynch raised the bulk of the investment capital for the $13.5 million initiative. For them to get a return on their investment, the program must either reduce recidivism by at least 8 percent or increase the rate of employment for released prisoners by at least 5 percent compared to historic averages. If the investors achieve their performance goals, reduced prison and public-assistance costs will save New York taxpayers $7.8 million.

Illinois is using pay for success to improve placement outcomes and reduce re-arrests for young people involved in the child-welfare and juvenile-justice systems. Massachusetts is employing the model to improve employment outcomes and post-secondary degree attainment among participants in adult basic education. The Obama administration has also gotten into the act, funding a model project in Ohio and committing $500 million to fund other state and local pay-for-success programs.

California is the latest state seeking to launch a pay-for-success program. A bill that has passed the state Senate and is awaiting action in the Assembly would create a pilot program beginning next year under which the director of the state's Office of Planning and Research would identify and submit potential "social impact partnerships' to the legislature for its consideration each year between 2015 and 2020, when the pilot would sunset. Seed money would come from a Social Innovation Financing Trust Fund. As in other states, investors would be paid only if the desired goals are achieved.

In a government culture that too often focuses on inputs, such as how much money is spent on a program rather than on the outcomes it produces, going through the goal-setting exercise alone makes the pay-for-success approach worthwhile.

To achieve the concept's full potential, the public sector will need to carefully monitor outcomes and become adept at writing contracts that hold investors' feet to the fire. But if governments succeed and shift the risk of failed initiatives from taxpayers to private investors, it won't take long for pay-for-success programs to become very popular.

GOVERNING.COM
BY CHARLES CHIEPPO | AUGUST 5, 2014

Fitch Rates First Nonbank-Sponsored Volcker Compliant TOB.

Fitch Ratings-New York-07 August 2014: The creation of a new nonbanking entity sponsored tender option bond (TOB) structure is positive for the municipal market (and tax-exempt money market funds in particular), as TOBs have historically given these funds access to municipal securities. On Wednesday, Fitch rated the first nonbank-sponsored TOB trust.

The Volcker Rule prohibits banks from sponsoring trusts and providing certain services for the floating and residual certificates issued by traditionally structured TOBs. In this particular transaction, Mesirow Financial, Inc. (Mesirow), a nonbank financial services firm, will serve as the trustor, trust administrator, placement and remarketing agent for the TOB trust. Prohibitions under the Volcker Rule pertaining to proprietary trading and certain hedge fund and private equity activities do not apply to Mesirow because it is a nonbanking entity. Furthermore, we expect the floating certificates and residual certificates issued under this trust will be owned by nonbanking entities, as the certificates issued by this trust would fall under the definition of a covered fund under the Volcker Rule.

The Volcker Rule became effective on April 1, 2014 and currently requires conformance by July 21, 2015. With the creation of this new structure, banks may potentially have the option of transferring sponsorship of existing TOB trusts to nonbanking entities to bring existing trusts into compliance with the Volcker Rule.

Contact:

Richard Park
Director
U.S. Municipal Structured Finance
+1 212 908-0289

Fitch Ratings
33 Whitehall Street
New York, NY

Trudy Zibit
Managing Director
U.S. Municipal Structured Finance
+1 212 908-0689

Rob Rowan
Senior Director
Fitch Wire
+1 212 908-9159

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

Fitch: US Local Government Pension Reform Hits Another Snag.

Fitch Ratings-New York-05 August 2014: This week's pension reform ruling in Los Angeles provides the latest example of the challenges local governments face in effecting pension reform, Fitch Ratings says. We believe this challenge is unusual as it concerns reform that only applies to new employees. Los Angeles' Employee Relations Board ordered the city council to rescind a 2012 pension reform that scaled back pension benefits for new employees of the Coalition of Los Angeles City Unions.

Legal challenges have been a frequent companion to pension reform efforts for some time and are unlikely to abate soon. Economic pressures have sensitized the electorate, officials, and employees to the costs of pension benefits and the potential relief possible with pension reforms. However, legal constraints and current and future beneficiary resistance favor preservation of current benefit levels. These issues are being considered by internal review bodies, courts and, at times, voter initiatives. Recent San Jose and San Diego cases were voter-driven and affected both existing employees and new employees. Neither case has reached final resolution.

Fitch considers the ability to adjust pension benefits for future employees to be critical to Los Angeles' financial flexibility. We believe Los Angeles will eventually be able to implement this reform, either through a judicial ruling or the meet and confer process. Similar reform has already been implemented for police, fire, and Department of Water and Power unions. This tentative decision will likely be finalized by the board next month and we expect the city to appeal the decision to the state court. Savings from the L.A. pension reform are estimated at approximately $4.3 billion over 30 years, beginning at close to $4 million in the first two years.

Contact:

Amy Laskey
Managing Director
U.S. Public Finance
+ 1 212 908-0568
33 Whitehall Street
New York, NY

Alan Gibson
Director
U.S. Public Finance
+1 415 732-7577
650 California Street
San Francisco, CA

Rob Rowan
Senior Director
Fitch Wire
+1 212 908-9159

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

SIFMA US Municipal Credit Report, Second Quarter 2014.

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 $83.4 billion in the second quarter of 2014, an increase of 38.8 percent from the prior quarter ($60.1 billion) but a decline of 6.2 percent year-over-year (y-o-y) ($88.9 billion). Year to date ending June, issuance figures reached $143.5 billion, well below the 10-year average of $190.7 billion due to light supply in the first quarter. Including private placements ($4.7 billion), long-term municipal issuance for 2Q'14 was $88.1 billion.

Tax-exempt issuance totaled $74.0 billion in 2Q'14, an increase of 38.9 percent but a decline of 0.2 percent q-o-q and y-o-y, respectively. Taxable issuance totaled $6.5 billion in 2Q'14, an increase of 19.4 percent q-o-q but a decline of 48.7 percent y o y. AMT issuance was $2.9 billion, a twofold increase q-o-q and a 39.3 percent increase y-o-y.

By use of proceeds, general purpose led issuance totals in 2Q'14 ($19.2 billion), followed by primary & secondary education ($17.1 billion), and water & sewer facilities ($6.7 billion), identical rankings as the prior quarter.

Refunding volumes as a percentage of issuance rose slightly from the prior quarter, with 52.7 percent of issuance compared to 48.8 percent in 1Q'14.

Download the Report.

Social Impact Bonds: Phantom of the Nonprofit Sector.

What issue could bring Senator Ted Cruz (R-TX) and Senator Al Franken (D-MN) into bipartisan partnership? Social impact bonds (SIBs)—or pay-for-success (PFS), depending on one's preferred terminology. Both legislators have been effusive about the reauthorization of the Workforce Innovation and Opportunity Act (WIOA), and Franken seems to have made workforce development one of his top priority issues. A core component of WIOA noted by many of its supporters was the legislation's $300 million commitment to pay-for-success programming aimed boosting effective, evidence-based efforts in job training.

For the two senators and most of the U.S. Congress, SIBs are real, immediate, substantive, and promising—enough to justify devoting hundreds of millions of dollars to pay-for-success programming on a range of social issues. For others, they are a public policy phantom, largely unproven but highly touted by some academics, a number of private foundations, and a bevy of consultants, and broadly endorsed by Republicans and Democrats, nonprofit service providers and for-profit entrepreneurs. As this issue of the Cohen Report explores, this potentially phantom program is getting serious consideration at the federal government level and in a variety of states.

The WIOA legislation is the latest piece of federal policy promoting SIBs/PFS as an avenue for public policy solutions to knotty problems. According to a fact sheet distributed by the office of Senator Patty Murray (D-WA), the bill's lead sponsor, up to 10 percent of funding for job training projects administered by local Workforce Investment Boards can be used for pay-for-performance initiatives. Don't think that this was a throwaway component of the legislation. Social enterprise lobbying groups like America Forward (which played a big role in the adoption of the Social Innovation Fund) lauded the PFS provisions of WIOA. America Forward, in fact, specifically noted its role in working with Senator Rob Portman (R-OH), Senator Michael Bennett (D-CO), and Representative Susan Brooks (R-IN) to get the PFS language included. (America Forward is identified as a "nonpartisan initiative" of New Profit, Inc., which was founded by Vanessa Kirsch, who herself founded Public Allies, and is governed by a 15-person board that includes three executives from Bain Capital as well as representatives of other investment firms.)

In America Forward's list of the "10 Greatest Hits from the Workforce Innovation and Opportunity Act," the PFS component ranks first and gets more word-space than any of the other "hits." Despite exceptionally limited experience in the U.S. and overseas with actual SIB programs or projects, the SIB/PFS juggernaut is going great guns due to enthusiasts such as New Profit. With President Obama's signing of the WIOA legislation earlier this week, it is an appropriate moment to take stock of where the SIB movement has made inroads into federal and state public policy and where it might go in the future.

Federal pay-for-success

The WIOA's pay-for-success provision is substantial. As many commentators have written, the amount of money available for workforce development training and placement programs could be as much as $300 million through the Act. PFS in WIOA fits the Obama White House's longstanding enthusiasm for SIBs. In its Fiscal Year 2012 budget explanations, the Office of Management and Budget observed that Pay for Success Bonds (even though they aren't bonds) involve philanthropic and private sector investors "to deliver better outcomes" for all levels of government and "minimize risk to government" (because government ostensibly only pays when outcomes are achieved).

In Fiscal Year 2013, the White House called for $100 million for PFS pilot projects. In its FY 2014 package, the White House proposed a $300 million PFS incentive fund to be administered by the Department of Treasury plus $195 million for PFS projects sponsored by the Departments of Labor, Justice and Education. Ironically, the White House suggested that its FY2013 proposal was justified in part by state initiatives such as the one "being implemented…as close as the State of Maryland," though Maryland's SIB program was the recipient of a devastating legislative report and eventually stalled in the legislature.

Not surprisingly, the WIOA authorization of workforce development SIBs follows the announcement of an $11.2 million SIB competition administered by the Corporation for National and Community Service's Social Innovation Fund. With applications due next week, SIF is looking to fund a number of nonprofits and government agencies with grants between $200,000 and $1.2 million to assess the feasibility of PFS efforts and build local capacity to implement them and between $200,000 and $1.8 million for structuring PFS programs. Given SIF's track record regarding its selection of New Profit as one of the original SIF grant recipients despite much concern about potential conflicts of interest in its selection process, including some trenchant observations from SIF reviewer Paul Light, one might wonder whether the numerous advocates of SIB/PFS programs like this one will do more than influence the agency to reward the major promoters of the concept. Hopefully, nothing that would raise those sorts of suspicions will happen this time around.

Social impact bonds must be a heady experience for a Congress that cannot bring itself to do much of anything in a bipartisan manner. Around the same time as the WIOA legislation was making its way through Congress, Representative Todd Young (R-IN), joined by Representative John Delaney (D-MD), introduced the Social Impact Bond Act with the support of a handful of other members, including a couple with national profiles—Aaron Schock (R-IL) and Joe Kennedy (D-MA). Young, however, is clearly the enthusiast behind the bill and described the purpose of the legislation on his website:

"Under the proposed legislation, the federal government would establish desired outcomes to pressing social challenges that, if achieved, would improve lives and save government money. State and municipal governments could then submit proposals to work towards those outcomes—such as increasing adoption rates of teenagers in foster care, or improving the health and mortality rates of infants born into low-income families—by scaling up existing, scientifically-proven interventions. Private sector investors would provide the capital needed to expand the existing programs, and, if an independent evaluator were able to validate that the desired outcomes were met and money was saved, the investors would be paid back their initial investment plus a small return from the realized government savings."

The logical implication of the Young legislation would be to convert an unending array of federal programs into potential SIB/PFS funding venues. Their language has a lot of belief and hope instead of evidence for these efforts based on evidence-based programming. For example, Delaney proclaimed, "The Social Impact Bonds already being implemented in the States prove it can be done, and if we want federal savings, we need to get the federal government involved." As he knows, probably better than most of his colleagues due to a trenchant analysis of SIBs prepared for the Maryland legislature and presented recently in testimony at a congressional hearing, there are only a handful of SIB/PFS programs underway anywhere—perhaps as many as four in the U.S.—and none have reached a point where they can be pointed to a "proof" of the SIB concept.

Delaney added, "This bipartisan legislation harnesses the power of the private sector to improve government services while saving taxpayer dollars." The history of privatization of public services has not been quite so across-the-board positive as Delaney intimated. Representative Joe Kennedy added an aggressive set of expectations for SIBs in public policy: "By breaking down traditional barriers between the public and private sectors, these tools expand our capacity to address everything from unemployment to child welfare to substance abuse treatment." Representative John Larson (D-CT) waxed enthusiastic about SIBs' ability to tap the "entrepreneurial spirit and innovation of the private sector."

The sales pitch is bold and strong regardless of whether there is sufficient experience behind SIBs to warrant the statements. An organization called Results for America recently convened a discussion with Young and Delaney under the moniker "Moneyball for Government," involving representatives of the Nurse-Family Partnership, the Center for Employment Opportunities, and the Manpower Development Research Corporation (MDRC)—all engaged in components of current or planned SIB/PFS programs—to embellish the Young/Delaney pitch. Moneyball's "founding all-stars" are also bipartisan luminaries: former New York City mayor Michael Bloomberg; former director of the Office of Management and Budget in the Obama administration, Peter Orszag; the former director of President Obama's Domestic Policy Council, Melody Barnes; former Republican Congressman and head of OMB in the Bush administration, Jim Nussle; and former director of the Domestic Policy Council in the Bush administration, John Bridgeland.

SIBs may be part of applying the theory of moneyball to government—like Billy Beane's Oakland Athletics, small money may yield outsized results on the playing field—but a handful of SIB experiments do not constitute a full season's worth of experience for making the kinds of glowing proclamations that SIB advocates typically do.

Although experience with SIBs is very limited and there are serious questions about how they might function, they have a coterie of advocates who are committed to promoting and promulgating SIB programs and legislation throughout the nation. With major supporters such as the otherwise liberal Center for American Progress (whose Q&A report on SIBs was co-authored by former Obama administration Office of Social Innovation director Sonal Shah), the private sector-lauding SIB concept draws in supporters who one might otherwise expect to have some qualms about the impact of private sector leadership in the solution of social problems.

State social impact bonds

Policy innovations often don't wait for evidence of their success, even when they are social impact bonds, which are predicated on private and public investment in evidence-based programs. State legislatures have considered several SIB bills or called for feasibility studies in recent months:

Earlier this year, the Washington state legislature voted to create a "social investment steering committee" to "develop an implementation plan for at least one pilot program that uses social impact bonds or other public-private financing mechanisms to finance and deliver prevention-focused social or health care services." As of June, however, supporters of the SIB pilot program were not able to get the legislature to back the legislation with appropriations. Although the primary sponsor of the SIB legislation, Republican state representative Hans Zieger, declared that SIBs would "provide incentives to solve problems versus reinforcing the bureaucratic status quo"—especially, in Zieger's mind, for K-12 education—Appropriations Committee chair Ross Hunter, a Democrat, took credit for having "killed" the program. Viewing private investment for SIBS as similar to borrowing money, Hunter said that Washington State doesn't typically borrow money for building social infrastructure. He asked, "If we have evidence to justify an investment, then why not put aside money for it?"

Utah this year created the Utah School Readiness Initiative with a significant commitment for SIB programs for "early childhood education programs for at-risk students." The Utah program follows a 2013 plan forwarded by the Salt Lake County Council for an early childhood education SIB with Goldman Sachs and Chicago venture capitalist J.B. Pritzker as investors, but the state government did not authorize its funding for the deal.

Goldman Sachs is the $10 million investor in the Rikers Island recidivism reduction SIB in New York City, which operates under a 75 percent guarantee from Bloomberg Philanthropies, essentially boosting Goldman's anticipated return on its investment from an already high 22 percent to over 87 percent. Billionaire Pritzker is the younger brother of Penny Pritzker, the Obama campaign bundler who was appointed Secretary of Commerce by President Obama last year.

This past spring, the Colorado legislature considered a bill to establish "pay for success contracts for early childhood education services program for the purpose of authorizing the office of state planning and budgeting (OSPB) to enter into state pay for success contracts with one or more lead contractors for the provision of early childhood education services that will reduce the need for the state to provide subsequent education support and other social services." However, in May, the state senate chose to delay further consideration of legislation for the time being.

Funded by the Duke Endowment and the Doris Duke Charitable Foundation, the Institute for Child Success issued a report in May with an enthusiastic endorsement of expanding the Nurse-Family Partnership program and other home visitation programs in South Carolina, concluding that "Pay for Success is a feasible and promising way to improve outcomes for South Carolina children." It should be no surprise, as the Institute has issued glowing reports on the feasibility of pay-for-success in September 2013 and January 2014 preceding this latest analysis.

In California, the Nonprofit Finance Fund (long supported on SIB/PFS activity by the Rockefeller Foundation) and the James Irvine Foundation have launched the California Pay for Success Initiative. As of May, NFF and Irvine announced the selection of five projects: the Center for Employment Opportunities and REDF to reduce recidivism and increase employment prospects for formerly incarcerated persons in San Diego County; the County of Los Angeles to “support the development of a County Blueprint for use by Los Angeles County Supervisors and executives in assessing and implementing potential Pay for Success opportunities”; the City and County of San Francisco to “enable greater focus on preventative services that is aligned with the Mayor’s strategic priorities in workforce development, housing, public health and human services”; the County of Santa Clara for two projects for “the chronically homeless and the acutely mentally ill” including the provision of 100 units of permanent supportive housing; and the Nurse-Family Partnership, “to scale its home visitation program in multiple Bay Area and Orange County locations.” Social Finance, the consulting entity involved in much of the SIB thinking around the country, also reports that it has been working with the California Endowment since 2013 on a “demonstration project in Fresno, California to reduce costs related to the treatment of children with asthma through active management. If the pilot program, which launched in April 2013, is successful, the partners plan to scale the intervention through a Social Impact Bond (SIB).”

Ohio also has a number of Pay-for-Success projects being considered. In Cuyahoga County, the PFS project would “help homeless children stay with their own families and avoid the foster care system.” The partners in this effort include Frontline, a provider of mental health services for homeless individuals, the county’s Division of Children and Family Services, the Cuyahoga Metropolitan Housing Authority, Case Western Reserve’s Center on Urban Poverty and Community Development, and Third Sector Capital Partners. Like the California program, Ohio’s exploration of SIB possibilities is related to a grant award from the Rockefeller Foundation to establish new SIB projects around the nation.

Ohio’s governor, Republican John Kasich, welcomed the Rockefeller Foundation SIB initiative in his state. In Illinois, a similar effort linked to the Rockefeller Foundation has spurred Governor Pat Quinn to launch efforts to explore SIB possibilities addressing recidivism rates, school graduation rates, and lowering hospital readmission rates. Quinn announced the SIB effort at the annual meeting of the Council on Foundations, prompting the Rockefeller Foundation CEO Judith Rodin to laud the governor for his “visionary leadership in advancing innovative ideas.” The first of Illinois’s SIB projects was announced earlier this year, a Pay for Success initiative to increase support for at-risk youth. The project is sponsored by One Hope United as the lead provider for the Conscience Community Network, a collaboration of seven longstanding child welfare service agencies. Providing technical assistance to the effort is, as in other situations, Third Sector Capital Partners.

Connecticut had legislation pending in 2013 and reintroduced in 2014 that would have authorized something akin to a Social Impact Bond, but the specific language seems to limit the structure of the SIB for “accepting a United States Department of Justice fiscal year 2012 Second Chance Act Adult Offender Reentry Program Demonstration Category 2 Implementation grant.”

Legislation in Rhode Island this year that would have authorized a SIB pilot program and created a study commission stalled in the state senate as a result of concerns from some interests about the impact of SIBs leading to a tendency to privatize some state services and that the promoters and financial beneficiaries of SIBs seemed to be large Wall Street firms. A significant part of the opposition was led by the state chapter of the American Federation of State County and Municipal Employees (AFSCME). Jim Cenerini, the legislative affairs director and political action coordinator for AFSCME Council 94, explained, “Our skepticism comes from the fact that the impetus for this was created by a large Wall Street corporation that obviously has something to gain, ideologically and financially, from the implementation of these bonds. It seems wrong that already very wealthy individuals should be able to make money off of reducing recidivism.”

Hawaii’s Department of Budget and Finance presented a report to the state legislature in December 2013 examining the feasibility of using Social Impact Bonds for early childhood education programs, concluding that “while there is much excitement about SIBs from various sectors of society, including government, philanthropy and investment banking…SIBs are in an infancy stage and have many complexities, [and therefore] it may be prudent to wait at least a few years to see whether SIBs grow into a viable financing tool.”

All of these state government initiatives follow earlier major state SIB announcements, such as a program in Massachusetts in 2012 that included an effort to increase the number of supportive housing units to be produced in partnership with the Massachusetts Housing and Shelter Alliance, the Corporation for Supportive Housing, Third Sector Capital Partners, and the United Way of Massachusetts Bay and Merrimack Valley, and Minnesota’s Pay for Performance Act, which authorized $10 million in Human Capital Performance (HUCAP) bonds for a variation of the SIB model.

The reality is that introducing legislation that adapts the standard language of SIBs, much like the legislation that spread for a couple of years promoting low profit limited liability corporations (L3Cs), is relatively easy. Getting legislation passed and seeing SIBs come to fruition and success are much more difficult. Many states have witnessed SIB legislation come and go over the years. The problem, as the Minnesota Council of Nonprofits’ Jon Pratt told Nicole Wallace of the Chronicle of Philanthropy, is that SIBs have “been overpromoted and oversold…We have yet to have a single transaction completed, and yet multiple states and multiple agencies are jumping ahead.”

Pratt’s point is at the crux of the matter. Any critical thought about SIBs gets volumes of commentary from legions of SIB promoters such as Social Finance, Third Sector Capital Partners, and a bevy of consultants who hope for roles and stakes in the movement. Few researchers have issued much in the way of critical commentary. With foundations such as Irvine, the California Endowment, and particularly the Rockefeller Foundation, whose former VP is now leading the Nonprofit Finance Fund in the SIB movement, it isn’t hard to imagine how much easier it is to get funding to write supportive analyses about the upsides of SIBs and how difficult it might be to get support for critical reviews.

With this beehive of activity promoting SIBs and PFS, none of which have reached a point where they demonstrate success or failure, how much do we really know about the concept? Writing in The Hill last month, Deborah Smolover, the executive director of New Profit’s America Forward, suggested some interesting conclusions about this relatively young policy concept—or about the assumptions behind it. She wrote, “Too often, public programs have no incentive to find the most productive providers. In many cases, they don’t even measure results, making it hard to tell which providers are the most effective. By failing to track outcomes, decoupling funding from effectiveness, and prioritizing compliance with rules (and even proscribing new approaches), most government programs actually discourage innovation.”

Noting that “this innovation cycle rarely operates in the public sphere,” Smolover writes, “In the business world, the opposite is true. There, new value is created every day through innovation. The concept is simple: A product, service, or process is invented and tested. If it is successful, it attracts investment to take it to market, and then to expand its reach. Profits gleaned from the invention can be reinvested in research and development efforts that will result in continuous improvement or new inventions that will displace the original. And if customers don't want the product, it goes away (unlike government programs that may stay in existence long past their useful life.)"

Besides being an unbelievable slight to everyone who has tried—and in many cases, succeeded—in making government work for poor people in the solution of social problems, Smolover's view of a pristine private market that doesn't promote and sell products that people don't need or that cause harm is almost quaint. Will SIBs and PFS initiatives supported by investors from Goldman Sachs, Bank of America, or J.B. Pritzker lead suddenly to a creative, innovative governmental sector woken from the doldrums that Smolover and her colleagues think envelop those of us who have worked for government? Will, somehow, private sector principles work where government has purportedly failed?

That's the bet that Ted Cruz, Todd Young, and New Profit are making, imagining evidence of success in SIBs and PFS that really hasn't been achieved yet, here or overseas. It's a public policy bet that has legislators of both parties and at the national, state, and local levels hopeful that private capital will somehow discover and fund public policy solutions that wouldn't come to the fore without SIBs. It is a bipartisan dream built on a belief in the efficacy of the free market system that hasn't borne much social progress fruit in recent years and rooted in a disparaging view of public servants, who have accomplished more than most free market true believers might ever guess.

WRITTEN BY RICK COHEN JULY 2014 13:59

Army Corps to Solicit Public Comment on P3 Pilot Program for Water Projects.

The Army Corps of Engineers will hold a "listening session" on Aug. 27 to solicit ideas and recommendations from the public on ways it can implement a new pilot authority to establish public-private partnerships for building water infrastructure.

The session is one of four the Corps will hold in August and September to gather public comment on implementing various provisions in the recently enacted Water Resources Reform and Development Act (WRRDA). The legislation requires the Corps to develop a P3 pilot program allowing non-federal partners to carry out water resource development projects, including coastal harbor improvement, channel improvement, inland navigation, flood damage reduction, aquatic ecosystem restoration, and hurricane and storm damage reduction. Up to 15 projects are authorized under the program.

The Aug. 27 session will focus on alternative financing through contributions from nonfederal interests and innovative financing for water utility improvements. The other three sessions will cover the following topics:

The Aug. 13 session will focus on deauthorizations, backlog prevention and project development and delivery

On Sept. 10, the Corps will discuss safety issues on the nation's levees and dams and other regulatory issues.

The final listening session on Sept. 24 will cover non-federal implementation, water supply and reservoir issues and navigation issues on the national waterways.

The listening sessions will take place via webinar, allowing participants to join by telephone or

Internet, according to the Federal Register announcement. The Corps will also gather written comments from the public throughout the comment period.

WRRDA authorized an estimated $5.4 billion for Corps projects between 2015 and 2019 and will cover construction and maintenance of locks, dams, levees, navigation channels, harbors and environmental restoration projects.

July 30, 2014

U.S. Treasury to Put Public Pensions Under Scrutiny.

Aug 4 (Reuters) – The Treasury Department's new office on state and local finance will scrutinize public pensions, appointing a specialist in the area and becoming a resource for retirement planning, its inaugural director said in a speech on Monday.

State and Local Finance Office Director Kent Hiteshew told a meeting of the Council of State Governments that he had appointed the chief investment officer of Maryland's pension fund as a policy adviser who "will substantially strengthen our office's understanding of the critical challenges facing a system upon which approximately 23 million Americans depend … for their retirement security."

Saying that state and local pensions now have enough money to cover only 72 percent of their costs, in comparison to nearly 100 percent in 2000, Hiteshew added that very few pensions are well-funded.

"While the current underfunding started prior to the Great Recession, this was exacerbated by both market forces and trying fiscal times during the last few years," he added.

Public pensions had $4.89 trillion in assets in the first quarter of 2014, the highest on record, according to data from the U.S. Federal Reserve. But they also had the largest liabilities on record going back to 1945 – $5.03 trillion – and their funding gap has widened since the 2007-2009 recession.

That recession devastated investment returns, which are the chief revenue source for pensions, while simultaneously forcing states to cut retirement contributions. While investments are gaining and many states have increased contributions, public pensions face a bulge of retirees from the "Baby Boom" generation.

Hiteshew's office will study the state of public pensions and help retirement systems evaluate their financial conditions, and it will look into the growing costs of retiree healthcare.

Also on the office's agenda are President Barack Obama's push for more infrastructure financing, including creating a program akin to Build America Bonds, and continued monitoring of the financial situation in Detroit and Puerto Rico.

Build America Bonds were created by the 2009 economic stimulus plan, and the program expired in 2011.

The once popular bonds, which were taxable and paid issuers a hefty rebate, lost their appeal when the rebates were cut during congressional budget battles. Issuers have been slow to warm to

Obama's proposal of "America Fast Forward" bonds that follow the same model, and which the administration says would be protected from spending cuts.

Hiteshew, formerly J.P. Morgan's managing director for public finance in its northeast region, also intends to help improve liquidity, pricing transparency and financial disclosure in the $3.7 trillion U.S. municipal bond market.

The Treasury Department announced the creation of the office in April, nearly two years after John Cross left his position as associate tax legislative counsel at Treasury, where he had spearheaded major municipal bond initiatives.

The federal government's heightened interest in the market is apparent across many agencies, including the Securities and Exchange Commission. On Friday, Republican Commissioner Michael Piwowar called for better municipal bond pricing information in the market.

Tue Aug 5, 2014 2:00am IST

(Reporting By Lisa Lambert; Editing by Paul Simao)

GASB: What You Need to Know About Accounting for Leases.

Governments regularly enter into leases for any number of reasons. Leasing can often be an attractive option for governments to have the benefit of certain necessary items—including vehicles, heavy equipment, and buildings—without having to purchase them outright.

Leasing also can offer greater flexibility to governments who do not need the items for their entire useful lives, or to governments who do not wish, at least initially, to take on the burden of ownership. Some governments also lease assets of their own to others.

In the lease accounting area, the existing GASB guidance is nearly identical to the Financial Accounting Standards Board's (FASB) guidance. Because the FASB has an active lease accounting project underway, it makes sense for the GASB to look at its existing lease accounting standards to consider whether changes would be appropriate.

The Board is very much engaged in deliberating lease accounting issues viewed through the governmental lens, but is closely monitoring the FASB's leases project and the approaches the FASB has elected to take thus far.

Last summer, as the GASB was preparing to begin deliberations on its lease accounting project, the FASB project staff presented an education session to GASB members to brief them on the FASB leasing proposals. Since then, the GASB and FASB project teams have been meeting periodically to discuss project issues and tentative decisions made by the respective Boards.

A major area of consideration in the GASB project on lease accounting relates to the manner in which leases are shown in the financial statements (and disclosed in the notes) that would meet essential financial statement user needs. The project is considering the following issues:

- The types of leases entered into by state and local governments
- The information users need regarding governmental leases
- Whether current accounting and financial reporting standards are appropriate to meet those needs

- Whether there should there be a distinction in how different types of leases are accounted for
- If current standards are not found to be adequate, whether additional potential requirements should be considered.

Based on deliberations to date, the Board has tentatively decided to propose a new accounting model for both lessees and lessors that would eliminate the current distinction between operating and capital leases.

All lessee governments would report in their financial statements:

- An intangible asset that represents the government's right to use the leased asset (rather than the leased asset itself), and
- A corresponding liability for lease payments.

This would apply for all leases except those that meet the definition of a short-term lease. During the lease term, government lessees would report a lease expense that is composed of:

- The amortization of the lease asset (recognizing the asset amount as an expense over the term of the lease), and
- Interest on the lease liability.

Government lessors would recognize a receivable for the right to receive payments and a corresponding deferred inflow of resources. Over the lease term, the deferred inflow would be systematically reduced and reported as lease revenue. Lessors would not remove the leased asset from their financial statements.

The GASB is scheduled to release its initial lease proposal later in 2014.

S&P: Why Unfunded Congressional Mandates Pose Little Threat to U.S. State and Local Government Ratings.

Standard & Poor's Ratings Services has long held the view that U.S. state and local governments enjoy a significant level of fiscal autonomy from the federal government that many of their international peers do not. With locally derived revenue streams, the discretion to determine service levels, and the ability to raise revenues, state and local governments generally have greater autonomy than local governments in countries where the central government controls finances. This forms the foundation of a more limited rating relationship between the U.S. federal government and U.S. state and local governments than exists in many other countries around the globe.

Continue Reading.

29-Jul-2014

McKinsey: Creating Growth Clusters: What Role for Local Government?

A systematic approach to implementation could help start-up ecosystems flourish.

Many governments in industrialized countries aim to encourage entrepreneurship and start-up activity to spur job creation and economic growth. To what extent governments are capable of doing so is uncertain. Nonetheless, policy makers at the regional and municipal levels are closer to the sources of innovation than those at the national level. For example, innovation in the form of start-up activity tends to occur in large metropolitan areas, initially without the involvement of policy makers. Take Berlin, where a vibrant ecosystem developed in the past several years without systematic government intervention.

While an enabling policy context might not be a precondition for seeding entrepreneurial activity, it may become more critical when taking a cluster to scale. To flourish, entrepreneurial activity requires a concentration of talent, infrastructure, capital, and networks—key success factors of a start-up ecosystem, as epitomized by Silicon Valley. Not all economic-policy instruments aimed at nurturing start-ups are at the city level. Still, local policy makers should think systematically about what it takes to support a start-up ecosystem. When doing so, their focus could be on tackling the bottlenecks and constraints that might otherwise inhibit a vibrant start-up ecosystem rather than picking winners by supporting investment in particular sectors or business models.

More specifically, such local initiatives can help link entrepreneurs to schools and universities, ease administrative matters for foreign workers and founders wishing to settle in a location, support development of suitable infrastructure and connectivity, and communicate and market the attractiveness of a location vis-à-vis other start-up centers. New York, for example, founded a tech campus for applied sciences; Tel Aviv built working spaces for entrepreneurs; Berlin is in the process of setting up a privately managed fund to raise capital for start-ups.

Establishing a coherent and supportive entrepreneurial policy at the city level is challenging. Municipal decision makers should identify bottlenecks in the start-up ecosystem and design and carry out initiatives to address them. These moves require a project-oriented, dynamic, and capable organizational structure. This article outlines an implementation approach that local policy makers can use to strengthen a start-up ecosystem. It discusses, in particular, the concept of the start-up delivery unit—an approach employed recently by the mayor and municipal government of Berlin.

Spurring innovation in a dynamic, multistakeholder environment

Berlin, London, New York, and Tel Aviv are cities that stand out for their vibrant start-up ecosystems. London started its East London Tech City in 2010; New York and Tel Aviv have established New York Digital City and Start-up City Tel Aviv. In 2014, Berlin started implementing several initiatives.

These cities faced common challenges in defining and carrying out the initiatives, including having to deal with many stakeholders that create the potential for bottlenecks. A successful start-up policy must fulfill two requirements:

- The ability to keep pace with the start-up environment. The start-up world is volatile; investors and founders, and their needs and activities, change rapidly. Policy makers cannot pick winners in such an environment. Instead, they should focus on enabling structures that can address more fundamental requirements.
- The ability to succeed in a multistakeholder environment. When starting initiatives to spur innovation, there are many competing interests: stakeholders from the private sector, such as venture capitalists, corporations, and start-ups; diverse levels of governments; and universities and research institutes. Bringing together and managing those stakeholders and interests are essential to successful implementation.

We have found that start-up delivery units—situated primarily in the mayor's office—are an effective, pragmatic way of realizing these two requirements. Start-up delivery units are inspired by broader governmental delivery units, an approach employed worldwide to facilitate program implementation. Governments have used delivery units for more than 15 years to rigorously track performance, identify obstacles early, solve problems, and correct course. They vary in scope and size but generally are not too large. They can be centralized or within line agencies. McKinsey’s study of delivery units and work with governments on them show that the most successful share several important characteristics: an outstanding leader with a track record of delivering outcomes, direct access to top leadership, talented staff with excellent communication and problem-solving skills, and the ability to use soft power to influence ministries.

Employing a start-up delivery unit

A delivery unit drives and coordinates start-up activities and helps cities progress much more rapidly than they otherwise might. The unit should mirror as much as possible the ad hoc way start-ups do business and provide a credible focal point for immediate problem resolution, stakeholder engagement, and response. We have identified three important steps to launch a start-up delivery unit.

Hiring the right talent

Policy makers’ experience in London and New York suggests that finding the right kind of people to work in start-up delivery units is challenging. The participants must understand how to function not only in the volatile world of start-ups but also in the steadier, slower-paced environment of public administration. Successful start-up delivery units hire an established entrepreneur as their managing director and seek the best talent they can find from within public administration and established companies. Rotating employees in and out of the unit can help it remain fresh, open to new ideas, and improve dialogues.

One way to help overcome skepticism of start-ups toward policy makers is engaging an established entrepreneur to lead the delivery unit. In London, Eric van der Kleij, the founder of the successful start-up Adeptra, was appointed to lead the London Tech City Investment Organisation (TCIO); in New York, Rachel Sterne Haot, the former CEO of the global crowdsourced news start-up GroundReport, was appointed chief digital officer of the NYC Digital program.

The job description should be similar to other top government or private-sector roles. The ability to truly shape the city’s start-up ecosystem is critical. Direct reporting lines to the mayor ensure not only flatter hierarchies and clear chains of command but also imply a career launchpad for the managing director of the unit through enhanced visibility. Of course, competitive salaries and sufficient budget help attract talent as well. London’s TCIO, for example, has an annual budget of £2.1 million pounds, 61 percent of which is spent on the salaries of the delivery unit.

Even competent leadership will only succeed if complemented by a cutting-edge team consisting of 8 to 12 talented private- and public-sector employees. Getting start-up founders themselves to dedicate substantial time is difficult. Instead, the delivery unit could aim for entrepreneurial talent from other private-sector companies and government bodies. London’s TCIO hired staff from Siemens, as well as long-term public servants previously involved in trade and investment promotion.

Additionally, to ensure the delivery unit will not revert to the somewhat slower-paced world of public administration, permanent rotation of staff into and out of the unit is an option and has proved to boost morale in other public-sector contexts (for example, in Denmark, Germany, and Norway).

Conducting ‘delivery labs’

Once the delivery-unit team is in place, a “delivery lab” can be used to inject ideas and translate high-level strategies into detailed implementation plans. A lab is an intense problem-solving environment that collocates the 20 to 40 key people needed to crack a problem. Delivery labs can also help build team spirit and momentum. Labs may comprise workshops of several days with relevant stakeholders, including venture capitalists, corporations, start-ups, diverse levels of governments, universities, and research institutes. For instance, the lab would attempt to pinpoint the key areas of actions in a start-up ecosystem. Questions like the following may be answered: What can we do to increase capital availability in our city? How can we ensure there are enough coworking spaces at reasonable prices? Taking into account that the start-up environment changes rapidly, analyses and solutions should be updated regularly. Ideally, such labs are conducted annually.

To assess the status of a start-up ecosystem in a delivery lab, a systematic and data-driven analysis aiming to clearly define and redefine the challenges to be addressed is valuable. By providing a data-driven basis for decision making, this analysis not only aids in obtaining buy-in of stakeholders but also helps the delivery unit to regularly update problem definitions and identify the root causes of problems.

Based on the problem definitions and the identified root causes, delivery labs can also be used to assess whether existing solutions are still adequate. Some employ “premortem analysis,” a managerial tool used in the private sector to identify implementation obstacles (exhibit). In step one of such an analysis, all initiatives to be implemented are outlined. Then, delivery-lab participants are asked to imagine a worst-case scenario for each initiative and predict why it might fail. Next, responses to each potential failure are designed. To track the progress of initiatives, some start-up delivery units publish an annual report after a delivery lab.

July 2014 **|** byJulian Kirchherr, Gundbert Scherf, and Katrin Suder

---

Momentum Continues to Build for P3S.

Interest in P3s continues to grow as governments aim to stretch their tax dollars earmarked for infrastructure projects, an expert panel told an audience Monday at NCPPP’s P3 Connect.

In an era of shrinking government and a public weary of the private sector’s profit motive, the key to project success is conducting a thorough financial review, open communication with the public and the willingness of local officials to understand these complex projects.

“There’s a big difference in P3s for railroads, airports, waterworks, highways and roads and utilities and we need to put them on a spectrum of how different they are from one another,” said Diana Carew, economist and director of the Young American Prosperity Project at the Progressive Policy Institute. “What they do all have in common is the need for the proper policy and legislative framework. There are still some states that lack P3 frameworks.”

Lately, the private sector’s sustained interest in P3s has begun to be shared by government agencies recognizing the role P3s can play in building infrastructure, according to Bill Johnson, director of Miami-Dade Water and Sewer.

Public support for partnerships continues to be an important determinant in the success of P3s, the panelists agreed.

“For the public, having an understanding what a P3 contract is trying to achieve is so important,” Len Gilroy, director of government reform at the Reason Foundation, told the audience. “What may be intuitive for a policymaker may not translate for members of the public. Communicating the decision-making process is very important.”

Finally, the panelists noted the importance of seeking outside advice when entering into P3s.

“Ultimately, much of the financial counseling public agencies look for can be outsourced,” said Emilia Istrate, director of research and outreach at the National Association of Counties. Of the 31 pieces of legislation proposed at a state level in 2011, 14 expressly allowed public agencies to bring in external consultants to help explain the complexities of P3s and to help the state work with the private sector, according to Istrate.

P3 Connect: Defining the Future of P3s in the U.S will run through Wednesday.

By Editor July 29, 2014

Should Someone Audit Government Auditors?

There’s a push for local governments to establish independent audit committees.

The California state auditor’s office raised lots of eyebrows around Sacramento last spring. In an annual review of the state’s financial statements, auditors identified more than $30 billion worth of errors. They found faulty accounting assumptions, transactions recognized incorrectly and simple arithmetic mistakes, among other problems. Fortunately, these errors were corrected before the final financial report was published.

In a state with almost $300 billion of assets, enormous pension funds and dozens of quasi-independent entities under its purview, a few small mistakes can quickly add up to $30 billion. Controller John Chiang, whose office prepares the financial statements, characterized many of these as honest errors attributable to understaffing and a lack of clear internal procedures — fixable problems.

In fact, there are those who think this is how public financial governance should work: An entity within the government that is also independent of it reviews that government’s financial policies, procedures and reports. When that entity finds errors it shares those errors directly with the governing body. The government then fixes those mistakes. For those who subscribe to this more “corporate” style of financial governance, the California episode is an uplifting story of what’s possible. It might also illustrate things to come.

Throughout the past decade, public companies have overhauled their financial governance practices. Much of that change was brought about by the 2002 Sarbanes-Oxley Act passed in the wake of the Enron scandal. Enron was a colossal mess in part because its auditors rarely questioned management’s aggressive accounting and financial reporting tactics.

In the post-Sarbanes-Oxley world, public companies must establish, among other things, an independent audit committee that oversees the financial audit process, reviews financial policies and procedures, and generally monitors a company’s financial inner-workings. If the audit committee spots a problem, it can circumvent management and report directly to the company's board of directors.

Experts disagree — sometimes pointedly — about whether these reforms have worked, but there's no question that these reforms changed financial governance forever.

States and big cities that elect an auditor or create an audit committee can realize many of these oversight benefits. According to some recent academic research in this area, only about one-third of smaller local governments and one-half of big cities have voluntarily established an independent audit function. Most that have not say their internal controls and other financial governance structures are strong enough. Others say audit committees are so politically sensitive that the benefits don't usually outweigh the costs.

But this might change. Around the time the California auditor's office published its findings, the Association of Local Government Auditors (ALGA), the main professional association in this area, published its long-awaited guidance on independent audit committees. ALGA recommended that local governments not only establish an independent audit committee, but also make certain that the committee includes financial experts who are not members of the governing body. The guidance goes on to say that properly resourced audit committees should have access to outside experts who can help make sense of complex or unforeseen financial issues.

Hypothetically, this could include everything from decisions about whether to issue debt to the funding of pension plans to how much money to keep in a rainy day fund.

ALGA's message is subtle, but clear: As public finance becomes ever more complex, even small local governments need a competent, vigilant, independent and expansive voice to make sure the public's money is managed prudently. The independent audit committee model is far from perfect, but it seems to have emerged as the go-to model, for now.

GOVERNING.COM
BY JUSTIN MARLOWE | AUGUST 2014

Pushing the Community Reinvestment Act into Unchartered Territory.

A handful of communities are putting CRA funds toward more than just housing projects.

A health clinic in the San Francisco Bay Area. A transit-oriented development in Denver. A mixed-use plan in a run-down neighborhood in Dallas. When it comes to how these places and a handful of others view and leverage the Community Reinvestment Act (CRA), they are breaking through old barriers.

All of which brings a measure of satisfaction to Bob McNulty, longtime community development activist and president of Partners for Livable Communities. These are exactly the sort of CRA-funded projects that he would like to see take root all across the country.

For years, however, it's been a challenge to move the key players in any CRA deal — banks, regulators and community development advocates — in new directions. The reason gets down to a basic tenet of the CRA: The program, aimed at low- and moderate-income neighborhoods, is rooted in housing. As a result, there has been resistance and a good deal of caution when it comes to thinking about investing in new and different things.

Part of that resistance revolves around an active game of finger-pointing. Banks say that regulators aren't willing to be open-minded about different types of investment, so they're stuck in the housing box. Regulators say they are more than willing to work with banks on testing new investment strategies aimed at low- and moderate-income neighborhoods, but that the banks are evincing a chronic failure of imagination. Community development activists complain that regulators are, in general, going way too easy on banks when it comes to crediting them for "CRA-worthy investments." There is, the activists say, chronic grade inflation.

McNulty describes it succinctly as a "conspiracy of caution," where bankers and regulators have settled into a comfortable routine of business as usual. Bankers don't have to think very hard about new ways to invest in communities. Regulators can cruise along in their comfort zone of monitoring straightforward home loans and housing projects.

There is no doubt that when the CRA was passed, it was aimed primarily at housing. The impetus for it was a disturbing pattern of active disinvestment by banks in low-income and minority areas around the country, particularly with mortgages but also in the area of small business loans. Called "redlining" — because it appeared that banks were drawing red lines around population centers where they considered residents to be bad bets for loans — the practice finally got the attention of the U.S. Senate Banking Committee in the mid-1970s.

At that time, a two-year Banking Committee study found a clear pattern of redlining nationally. Just over 10 percent of money deposited in Brooklyn banks was actually reinvested in the community. Only 10 percent of deposits in Washington, D.C., were reinvested there, with similar ratios turning up in key cities like Cleveland, Indianapolis, Los Angeles and St. Louis. By then, Congress had apparently seen enough, and, over the strong protests of those in high finance, it passed the Community Reinvestment Act of 1977.

Under the new law, banks were being asked to redirect a portion of their lending capital to low- and medium-income areas within a defined geographical range covered by the bank. Regulators would, in turn, do regular reviews of bank lending practices to gauge compliance. There has long been a debate about what sort of investments the CRA should focus on and which ones pass muster. Today, there's an additional debate about "geography" and "banking." There's a new world of Internet finance and spinoff financial institutions. Some of these financial entities aren't technically banks, but they are key to homeownership and other housing projects.

Under the CRA there aren't any fines or other direct penalties for failure to measure up. But a bank's ranking — either "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance" — determines whether or not it will win approvals from federal regulators for such key business moves as adding a branch or proceeding with a merger.

For years, some community development activists, like McNulty, have been arguing that bankers and regulators ought to think more holistically about investing in low- and moderate-income areas. That is, there's more to a community than just housing, that a community's economic welfare is directly affected by creating more livable places generally and helping build a healthy, educated and prosperous populace specifically. It appears that those who are pushing for that more sweeping view are starting to gain traction.

"There's some movement in getting out of the affordable housing box," says Ellen Seidman, a senior fellow at the Urban Institute, who focuses on housing finance and community development. The perception, she adds, has been that regulators "don't have a lot of creativity or imagination and that lenders didn't want to take risks." In order to break the chicken-and-egg cycle, "You need chicken, eggs and farmers," she says.

As it turns out, one of those farmers is a fed. Elizabeth Sobel Blum, senior community development adviser with the Federal Reserve Bank of Dallas, is a proponent of a growing movement for a much broader view of CRA investment. Writing in a recent federal reserve paper aimed at CRA compliance officers, she called for a "healthy communities framework" that "involves creating an environment in which there is an abundance of healthy choices." She notes that there aren't any "right answers" when it comes to evaluating a bank's compliance, but she wouldn't mind seeing banks credited for more than just helping with housing or small business development.

Other feds appear to be joining the chorus. "We do try to promote creativity," says Paul Kaboth, vice president for community development at the Cleveland Federal Reserve. His shop is actively working with banks to think more broadly about things like skills training, social services, counseling and day care. "You don't look at it as just housing or small business loans as much as what you're providing to low- and moderate-income individuals," he says. The rub, he suggests, is not so much bankers' resistance to new ideas as their basic conservatism.

Nonetheless, some major financial players like Wells Fargo, Goldman Sachs and FirstBank are getting into the CRA game. As they do, there are adjustments that bankers need to make. CRA is different than the usual deal-making. "Lots of players have to be involved," says Rob Chaney, who oversees loan operations for FirstBank in Lakewood, Colo., "and someone has to be the champion. There's a great need for someone to beat the square peg into the round hole."

As to state and local government, Chaney sees a potential role for the public sector to work in concert with community development organizations. Together, they could come up with more sophisticated investment options for a wide range of issues facing communities beyond housing. In that regard, community activists may have to step up their game. By way of example, he points to the issue of food deserts — the lack of fresh food or supermarkets in low-income neighborhoods. "The tendency," he says, "is to just throw money at the problem versus asking if there's a sustainable business model that we can help build that gets businesses to come in and invest, and that has community involvement and engagement to prove that people are really interested in solving these issues over the long term." The target community itself has to mobilize for banks to have confidence in a deal, he notes.

Indeed, the most successful initiatives are the ones where the community is involved from the start. "When I look at successful community development projects," says Karl Zavitkovsky, who heads up Dallas' Office of Economic Development, "it's important to have community buy-in and it's important to have a willing financial institution. You can do things in a physical sense, but if the community isn't aware of the new clinic or new school or retail center, it just doesn't work as well."

Acting as a convener is one very important role the city can play, Zavitkovsky points out. But cities can do a lot more than simply be a meeting site for principals. Cities can help assemble viable parcels for development, put up city money to sweeten a given deal and perhaps help convince financiers that a city is willing to be a real partner in a project.

For example, Dallas just cut the ribbon on a project that is located next to a light rail line station and is across the street from a VA Hospital, which employs 4,000 people and generates a huge volume of patient traffic. Despite the location, there's never been much there in terms of services or livable housing. Local community groups, banks and developers came together to focus attention and investment on the area. For its part, the city bought the land, tore down some "hot sheet" hotels and swung some tax increment financing to help underwrite debt service on a U.S. Housing and Urban Development loan.

The new mixed-use project, Lancaster Urban Village, boasts an 18,000-square-foot development of retail shops along with a couple hundred apartments — a mix of market rate and affordable that made the project CRA-worthy. The project is in a section of Dallas that represents half the city's geographical area but that only delivers 15 percent of the city's tax base. That factor alone made the project important from a broad economic development standpoint. And, yes, to be CRA-worthy, such projects have to occur in a low- to moderate-income area, "but when you're looking to be successful in a neighborhood, it's really important to have a holistic approach," Zavitkovsky says.

For banks, that low- to moderate-income test should be as much of a focus as the type of project being funded, says the Cleveland Fed's Kaboth. "The worst possible outcome for a bank's CRA officer," he says, "is you go to your oversight committee and say we should do these loans in these Census areas and there's reluctance because they're not sure they'll get CRA credits." That's why he is happy discussing potential projects beforehand, although banks still need to understand that the proof will be in the finished pudding.

Given the success of several alternative and mixed-use projects involving the CRA, it's clear that there are bankers and regulators ready to disrupt the tradition of caution and move into previously uncharted territory. At that, though, the best projects are still the ones that make business sense, something on which regulators and bankers can certainly agree. "It has to make sense from a business standpoint," says FirstBank's Chaney. "It can't just be about the warm and fuzzy."

GOVERNING.COM
BY JONATHAN WALTERS | AUGUST 2014

Do We Really Need to Keep Building Convention Centers?

As a new book illustrates, the promised benefits rarely materialize.

Politically, it's almost irresistible. Revenue from hotel and other taxes, paid largely by people from other places, will be used to subsidize convention centers that lure those visitors to town to spend in hotels, stores and restaurants.

But a new book demonstrates a far less appealing reality. In "Convention Center Follies," Heywood Sanders, a professor at the University of Texas at San Antonio, tells the tale of projects that continue to be built and expanded at a record pace even though they almost always fail to deliver the promised benefits.

There was a little over 36 million square feet of exhibition space in the United States in 1989. By 2011, that number had nearly doubled to 70.5 million. The problem is that in the midst of a decades-long convention-space explosion, demand has remained flat at best.

Sanders describes the usual scenario in which local convention or visitor-industry officials complain that a convention center is jammed to capacity or, worse, that lucrative events want to come but are too big for an existing facility. Consultants are retained, and they invariably endorse either building a new convention facility or expanding an existing one.

The idea behind convention centers is to bolster the local economy by attracting visitors who would otherwise spend their money elsewhere. The best measure of success is the number of hotel room-nights they generate.

Sanders' numbers tell the real story. Washington, D.C.'s new convention center was supposed to deliver nearly 730,000 room-nights by 2010; the actual number for that year was less than 275,000. Austin, Texas' expanded center was supposed to bring 314,000 room-nights by 2005 but produced just 149,000. The 2003 expansion of Portland, Ore.'s convention center was expected to yield between 280,000 and 290,000 room-nights, but the actual number was 127,000 — far less than before the center's expansion. Atlanta, Chicago, Dallas, Milwaukee, Minneapolis, Pittsburgh and Seattle are among other cities that have had similar experiences. The challenge is to find an exception to the rule.

That's not all. When projects fail and debt service mounts, consultants routinely conclude that the center needs a "headquarters hotel," which at the very least requires a large public subsidy. Sometimes the lack of developer interest results in the hotel being publicly owned. It's a classic example of finding yourself in a hole and continuing to dig.

Many factors result in convention center feasibility studies dramatically overestimating economic impact, but one that stands out is the fact that about half of convention attendees are generally local-area residents who would still spend their money in the region if there weren't a convention to go to. Consultants generally assume that each convention attendee will stay in a hotel for three nights or more. But because of the preponderance of locals, the reality is generally about one room-night for each attendee.

The consultants don't compare their past projections against actual performance or use that performance to inform future estimates. Sanders quotes one such consultant, Charles H. Johnson, from a 2005 legal deposition: "Once the deal is done, if we're not engaged, we … give them our report, our final invoice, and wish them good luck."

And the consultants routinely use expansions that are underway in other cities (often undertaken at those same consultants' urging) as evidence of why subsequent clients need to expand to remain competitive. Another consultant, Jeff Sachs, was blunt in his comments to Forbes, saying, "You lose clients if you shoot down projects."

Sanders makes a strong case for what he believes to be the real goals behind convention-center development. Sometimes it's to increase area property values. Boston is an example of a new convention center being used to help jump-start a developing neighborhood. In other cases, the facility is seen as an anchor to insure against downtown erosion or, in cities like St. Louis, part of an effort to reverse neighborhood erosion.

All are worthy goals. But taxpayers deserve an honest debate about whether building or expanding a convention center is an effective way to achieve them. And the debate should be informed by realistic economic-impact projections. What we don't need is a continuation of the charade in which elected officials, local business leaders and convention consultants tout benefits that at least some of them know will never materialize.

GOVERNING.COM
BY CHARLES CHIEPPO | JULY 30, 2014

MMA Municipal Issuer Brief - July 28, 2014

Click to read the Brief.

California High-Speed Rail Bonds Revived by Appeals Court.

The California High-Speed Rail Authority can issue $8.6 billion in bonds to finance the U.S.'s first bullet train, a state appeals court ruled, putting the beleaguered $68 billion project back on track in a win for California Governor Jerry Brown.

While the proposed line from San Francisco to Los Angeles still faces several lawsuits, yesterday's ruling by a three-judge state appeals court panel in Sacramento removes a substantial roadblock to the project.

The agency suffered a setback in November when a state judge blocked it from issuing the bonds, saying its finance committee didn't adequately disclose reasons for the financing. The judge told the authority to withdraw its funding plan. The decision threatened to delay and increase the cost of the project, state officials said.

The appeals panel said California law doesn't require the agency to provide any support or evidence to back up its decision approving issuance of the bonds, while warning that the project still faces hurdles.

"Substantial financial and environmental questions remain to be answered by the authority in the final funding plan the voters required for each corridor or usable segment of the project," the court said. "But those questions are not before us."

Funding Plan

The court also reversed the judge's ruling that the rail authority had to redo its funding plan.

"The High-Speed Rail Authority has always been committed to building a modern high-speed rail system that will connect the state, precisely as the voters called," agency board chairman Dan Richard said by e-mail. "This system will be a clean, fast, non-subsidized service, and will create jobs and enable smart, sustainable growth while preserving farmland and habitat."

There will be more legal challenges, said lawyers for the project's opponents, who are also weighing an appeal of yesterday's ruling to the California Supreme Court.

Access Monies

"We still have, and the court so indicated, an opportunity to challenge the legality of the authority's actions when the authority moves to the next step and actually tries to access the monies in the bond fund," Michael Brady, the attorney for John Tos, a farmer who sued, said in an e-mail. "They have to apply for that money through a different section of the law, a section which is actually much tougher on the authority with respect to what it has to prove."

The rail authority wants to lay tracks for trains running as fast as 220 miles (354 kilometers) an hour from San Francisco to Los Angeles. That became a more difficult goal after the U.S. Congress cut funds for such projects in 2012.

The state is buying land and rights-of-way needed for the rail line, which is scheduled to begin running three-hour trips by 2029. The project is being challenged by landowners, farmers and taxpayer groups, who say it has so deviated from the proposal approved by voters in 2008 that it's now illegal.

The rail authority on July 24 won an appeals court ruling throwing out a challenge by some San Francisco Bay area cities to the routing of train tracks connecting the Bay area and the Central Valley. The court found that the environmental review of the project's impact was sufficient.

The case is California High-Speed Rail Authority v. The Superior Court of Sacramento County, C075668, California Court of Appeal, 3rd District (Sacramento).

By Karen Gullo Aug 1, 2014 8:22 AM PT

To contact the reporter on this story: Karen Gullo in federal court in San Francisco at kgullo@bloomberg.net

To contact the editors responsible for this story: Michael Hytha at mhytha@bloomberg.net David Glovin, Charles Carter

---

Moody's: Q2 US Public Finance Rating Revisions Consistent with Stabilizing Trend.

New York, July 30, 2014 — Rating revisions in the second quarter were consistent with an overall trend toward stabilizing credit quality in the US public finance sector, says Moody's Investors Service. Although the number of rating downgrades outpaced upgrades, the amount of debt Moody's upgraded surpassed the debt it downgraded for the first time in six years, a result of large state government upgrades including California and New York.

Despite stabilizing trends across public finance sectors, Moody's expects downgrades to continue to exceed upgrades during 2014, but with the possibility of further improvement over the next several quarters.

As usual, the vast majority of ratings remained unchanged during the second quarter, with movement found among only approximately 2% of all public finance ratings.

"Most public finance obligors will continue to see stability in their ratings as improving revenues and sound management practices support their credit profiles," says Moody's Analyst Chandra Ghosal. "However, some issuers across multiple sectors have not recovered all the ground lost during the recession. These include local governments with weak local economies, as well as colleges and hospitals with weak competitive positions."

During the second quarter, upgrades equaled $158 billion and accounted for 65% of the total par value of debt that had a rating change. The upgrades of California, with $86 billion in debt, to Aa3 from A1, and New York, with $62 billion, to Aa1 from Aa2, accounted for a large majority of this total.

Also during the quarter, New Jersey, with $32 billion in debt, was downgraded to A1 from Aa3, and Puerto Rico Electric Power Authority, with $8.8 billion in debt, was downgraded to Ba3 from Ba2. (It was later downgraded to Caa2 on July 1.) These actions accounted for close to half of the $84 billion in debt downgraded.

In all there were 282 rating changes in the second quarter, 91 of which were upgrades and 191 of which were downgrades. In the first quarter of the year, there were 247 rating changes, 97 upgrades and 150 downgrades.

The 529 rating actions through the first six months of 2014 were a 12% increase over the first half of 2013. However, much of the activity arose from Moody's US Local Government GO Methodology, which led to 256 local governments having their ratings being placed on review, with the final tally for rating actions at 95 upgrades and 68 downgrades.

"The methodology update had a modest impact on the sector, changing less than 2% of our nearly 8,300 local government GO ratings," says Moody's Ghosal.

For more information, Moody's research subscribers can access this report at

https://www.moodys.com/viewresearchdoc.aspx?docid=PBM_PBM173274

Global Credit Research – 30 Jul 2014

GFOA Secures Introduction of Legislation to Expand Availability of Bank-Qualified Bonds.

Last week, a bipartisan group of House lawmakers introduced legislation (H.R. 5199) 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 several months of work by GFOA's Federal Liaison Center with the offices of congressmen Tom Reed (R-NY), Randy Hultgren (R-IL), John Larson (D-CT) and Richard Neal (D-MA).

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 are not as familiar with their jurisdictions. As a result of these factors, many small issuers have 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 in 2009 to approximately $32 billion. However, despite the effectiveness of bank-qualified bonds and bi-partisan 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.

The GFOA urges members to reach out to their members of Congress and request that they co-sponsor HR 5199.

Tuesday, July 29, 2014

S&P: U.S. Regulated Electric Utilities' Annual Capital Spending Is Poised To Eclipse $100 Billion.

In recent years, U.S. electric utilities have intensified their capital spending, in part, to update and replace aging infrastructure. They've also had to boost spending to pay for smart grid technology, increased security to safeguard against physical and cyber attacks, and system hardening to protect against more volatile weather. Moreover, the industry is now exploring ways to meet the required carbon pollution reductions under the EPA's recently proposed Clean Power Plan, which seeks to reduce carbon dioxide emissions. Under this plan, utilities would likely generate less electricity from coal and more electricity from other less carbon-intensive sources, which would require significant incremental capital investments.

Standard & Poor's Ratings Services believes this ever-growing need to fund improvement projects and comply with upcoming regulations could pressure utilities' financial measures, resulting in almost consistent negative discretionary cash flow throughout this higher construction period. However, we expect that utilities will be able to maintain their largely investment-grade credit quality by effectively managing regulatory risk and possibly seeking new creative ways to finance the necessary higher spending levels.

Read the Report.

Ballard Spahr: President Obama Seeks to Expand Market for P3 Transportation Projects.

As part of his ongoing effort to urge Congress to address the nation's critical infrastructure needs, President Obama recently announced the signing of an executive order creating the Build America Investment Initiative (the Initiative). This government-wide Initiative is intended to modernize roads, bridges, and other public infrastructure by complementing government funding with private capital, and could lead to more innovative project financing through public-private partnerships (P3s).

The Initiative is designed to encourage collaboration between state and local governments and the private sector, expand the market for P3s, and make greater use of existing federal tax credit programs. The President's announcement serves as another reminder of how the federal government continues to shift subsidies for infrastructure from tax-exempt bonds to tax credits. The Initiative's three major components are detailed below.

Under the oversight of the U.S. Department of Transportation (USDOT), the Build America Transportation Center (the Center) will provide information and technical assistance about innovative financing strategies to state and local governments, public and private developers, and investors. Resources include:

'Navigator Service" for the Public and Private Sector. This service is designed to make USDOT tax credit programs more understandable and accessible to state and local governments and leverage both public and private project funding. In addition, it will provide resources for identifying and executing P3s to private sector development and infrastructure investors.

Improved Access to USDOT Credit Programs. The Center will encourage awareness and efficient use of existing USDOT resources, including the Transportation Infrastructure Finance and Innovation Act (TIFIA) program. TIFIA provides financing and loan guarantees to transportation projects; each dollar of TIFIA funding can support about $10 in loans, loan guarantees, or lines of credit. The Center will also focus on the use of other key USDOT programs, including the Private Activity Bond program and the Railroad Rehabilitation and Improvement Financing Program.

Technical Assistance. Best practices from states and communities that already have established successful P3s will be shared. Through a website and on-site technical assistance, the Center will provide information about USDOT credit programs, case studies of successful projects and examples of deal structures, standard operating procedures for P3s, and analytical toolkits. The Center also will help investors better understand how to use USDOT credit and grant programs together for project development.

Information To Reduce Uncertainty and Delays. In partnership with the interagency Infrastructure Permitting Improvement Center—part of the Obama administration's plan to modernize permitting—the Center will help local and state governments, project sponsors, and investors navigate the permitting process.

Build America Interagency Working Group

A federal interagency working group, co-chaired by U.S. Treasury Secretary Jacob Lew and Transportation Secretary Anthony Foxx, will conduct a review aimed at fostering greater private investment and collaboration beyond the transportation sector. The group will work with state and local governments, project developers, investors, and others to address private investments and partnerships in areas including municipal water, ports, harbors, and the electrical grid. The group will focus on improving coordination to speed financing and completion of regionally and nationally significant projects, particularly those crossing state boundaries.

Infrastructure Investment Summit

On September 9, 2014, the Treasury Department will host a summit on U.S. infrastructure investment. The summit will focus on innovative infrastructure financing approaches and highlight other resources for project development. Leading project developers and institutional investors, state and local officials, and their federal counterparts are expected to participate.

July 23, 2014

This publication was written by members of Ballard Spahr's P3/Infrastructure Group.

Attorneys in Ballard Spahr's P3/Infrastructure Group routinely monitor and report on new developments in federal and state infrastructure programs. For more information, please contact P3/Infrastructure Practice Leader Brian Walsh at 215.864.8510 or walsh@ballardspahr.com, Emilie R. Ninan at 302.252.4426 or ninane@ballardspahr.com, Steve T. Park at 215.864.8533 or parks@ballardspahr.com, or the member of the Group with whom you work.

BRIAN WALSH
TEL 215.864.8510
walsh@ballardspahr.com

EMILIE R. NINAN
TEL 302.252.4426
ninane@ballardspahr.com

STEVE T. PARK
TEL 215.864.8533
parks@ballardspahr.com

ABOUT BALLARD SPAHR
Ballard Spahr, a national law firm with more than 500 lawyers in 14 offices in the United States, provides a range of services in litigation, business and finance, real estate, intellectual property, and

public finance. Our clients include Fortune 500 companies, financial institutions, life sciences and technology companies, health systems, investors and developers, government agencies and sponsored enterprises, educational institutions, and nonprofit organizations. The firm combines a national scope of practice with strong regional market knowledge. For more information, please visit www.ballardspahr.com.

S&P: How Exposed are Bond Insurers to Issuers in Puerto Rico?

The credit deterioration of Puerto Rico's public corporations and recent legislative changes have raised investor concerns relating to the bond insurers. Director David Veno discusses the exposure different bond insurers have to Puerto Rican issuers.

Watch the video.

MSRB Adds Graphing Tools for Historical Yield Data on EMMA.

Alexandria, VA – To ensure that new graphing tools on the Electronic Municipal Market Access (EMMA®) website are useful to the broadest range of investors, the Municipal Securities Rulemaking Board (MSRB) today added a graphical display of yield information on EMMA.

The new graphs allow users to visualize historical yields over time for any of the nearly 1.1 million securities on EMMA, supplementing the trade price graphs that became available on EMMA in June 2014. The new yield graphs also are now integrated into EMMA's price discovery tool to enable investors and others to visually compare yield information for multiple securities with similar characteristics.

"With the launch of the price discovery tool last month, the MSRB provided investors with a new way of looking at trade data on EMMA to more quickly and easily gauge the price of a municipal security," said MSRB Executive Director Lynnette Kelly. "The addition of yield graphs on EMMA further enhances the accessibility and usefulness of EMMA trade data."

The MSRB's EMMA website supports market transparency by serving as the official source of free trade data and disclosure documents on virtually all municipal securities.

S&P: U.S. Public Finance Rating Changes Were Still Positive In The Second Quarter, But A Bit Less So.

The balance of rating actions in U.S. public finance continued to be positive in the second quarter of 2014, reflecting our view of gradually improving credit conditions and the ongoing implementation of our local government general obligation (GO) rating criteria. However, the positive tilt has declined somewhat and, at 2.23 to 1, the second quarter upgrade-to-downgrade ratio is lower than any other quarter since the second quarter of 2013. The lower upgrade-to-downgrade ratio is tied to our now having implemented our revised local government rating criteria, released in September 2013, to much of our rated universe of affected local governments. With economic conditions very similar to what they were nine months ago, the upgrade ratio has drifted back in the direction of where it was just before the implementation of our revised criteria. In addition, when we lowered New Jersey's GO rating in April, we also lowered all of the state's appropriation-backed debt.

S&P: Not All Loans Are Equal - Some Terms and Conditions That Make Disclosure Critical In Evaluating Credit Risk.

Standard & Poor's Ratings Services has commented on the need for U.S. public finance issuers that we rate to provide greater disclosure of their use of alternative financing products such as bank loans and direct-purchase debt. We have focused on our need to be made aware of these transactions so that we can analyze the potential credit risks inherent in them. In this article we highlight some of the actual terms and conditions that may be included in these transactions that, in our view, make disclosure to us essential for our evaluation of an obligor's credit rating.

With greater use of these products and a more diverse group of lenders, we find the terms and conditions less standardized and uniform, creating, in our view, potential for considerable credit risk exposure. In our opinion, this additional risk stems from potential acceleration of principal and interest payments, and the potential for cross–default provisions between alternative financing debt and capital market debt. The documentation under which the lender agrees to purchase the alternative financing often contains events of default or covenants with remedies that, in our view, increase the potential for triggering accelerated repayment of principal and interest. Combined with cross-default provisions, breached covenants and default events could accelerate not only payments under the alternative financing, but also capital market debt, which could create a liquidity crisis for the obligor and potentially have multi-notch negative rating implications.

Therefore, we regard as critical the incorporation of alternative financings into the analysis of an obligor's debt profile. Standard & Poor's typically reviews the events of default set forth in an obligor's debt issuance documents to determine if the remedies can pose stress to an obligor as outlined in our contingent liquidity criteria. If so, we then review the events for consistency with our criteria for analyzing automatic termination events for standby bond purchase agreements (those that permit termination without notice or funding). These typically include what we consider "major" events, e.g., the obligor fails to pay principal of or interest on or repudiates the debt issuance, the obligor fails to make payment on or repudiates any debt on parity with, or senior to, the debt issuance, or the issuer or obligor challenges the validity or enforceability of the debt documents. (For a complete list see USPF Criteria: "Standby Bond Purchase Agreement Automatic Termination Events".)

Our concerns with alternative financing agreements, and our focus from a credit perspective, is whether any "non-major" events, if triggered, could lead to a remedy such as rapid acceleration of debt repayment and in turn, liquidity stress for the obligor. "Non-major" events can cover the spectrum from very broad to very specific events, depending on the obligor.

Examples of "non-major" events we have seen in actual documents leading to immediate acceleration include:

- Failure to perform or observe any term, covenant, agreement, or condition contained in financing agreements related to a liability of more than $1,000,000;
- False statements. Any warranty, representation, or statement made or furnished to lender by borrower or on borrower's behalf, or made by guarantor, or any other guarantor, endorser, surety,

or accommodation party under this note or the related documents in connection with the obtaining of the loan evidenced by this note or any security document directly or indirectly securing repayment of this note is false or misleading in any material respect, either now or at the time made or furnished or becomes false or misleading at any time thereafter;
- An event occurs that could reasonably be expected to have a material adverse effect on the ability of the borrower to perform its obligations under the related documents to which it is a party ;
- Failure to maintain specific debt service coverage ratios;
- Failure to maintain specific debt to capitalization; and
- Insecurity: Lender in good faith believes itself insecure.

Other events leading to acceleration from 30 to 60 days:

- Failure to provide as soon as available, but in any event not later than 120 days after the close of each fiscal year the annual report of the borrower;
- Failure to provide the annual operating budgets for the borrower within 30 days of adoption;
- Failure to promptly give notice to the bank of the occurrence of the commencement of any litigation, proceeding, or dispute affecting the borrower which could give rise to a default;
- Failure to maintain primary banking accounts with the bank;
- Borrower is charged with any environmental violation that would likely have a material adverse effect on borrower; and
- Failure to receive unqualified audit opinion.

As these examples show, the financing documents may allow the obligor a specific cure period before an event of default leading to acceleration is triggered. The combination of the magnitude of potential accelerated debt relative to an obligor's liquidity, and the immediacy of such liquidity calls, will be key to our determining the impact on an obligor's outstanding rating.

23-Jul-2014

Bank Loans Grow In Municipal Market While Bond Issues Shrink.

Significant developments in the way municipal entities borrow money are under way. Last year, issuances of new municipal bonds in traditional municipal bond markets dropped to near historic lows and the outlook for 2014 is similarly weak. According to the Municipal Bond Credit Report, Fourth Quarter 2013, prepared by the Securities Industry and Financial Markets Association (SIFMA), new capital markets municipal offerings in 2013 totaled $315.2 billion, a 13% decline from 2012. Of this amount, $266.7 billion represented tax-exempt issuances. The SIFMA 2014 Municipal Issuance Survey forecasts the 2014 total issuances to be $309.5 billion, of which $265 billion is expected to be tax-exempt, marking another decrease in volume.

Of great interest to commercial banks is the fact that, in contrast to this downturn in offerings of traditional municipal bonds, there is a marked increase in the amount of direct lending by banks and other financial institutions to municipal borrowers. While exact numbers are difficult to come by, Standard & Poor's has estimated that direct bank loans to muni issuers may account for as much as twenty percent (20%) of new municipal borrowings.[1] While there is no single factor that explains this rather dramatic change in landscape, there are a number of significant reasons why this may be occurring.

First, interest rates have been at or near historically low levels for the last five or so years. This low interest rate environment has offered unique opportunities to refinance outstanding bond debt on more favorable terms by enabling banks to offer very competitive interest rates to municipal borrowers on both tax-exempt and taxable debt. This has proven to be true even after factoring in the full or complete loss of a corresponding interest expense deduction that financial institutions may incur to carry tax-exempt debt pursuant to Sections 265 and 291 of the Internal Revenue Code.

The “all in” cost of direct bank loans is also made more competitive by the absence of certain bond-related costs of issuance that are generally not part of a direct bank loan structure, such as the underwriter’s discount, rating agency fees, costs of preparing and printing an Official Statement, underwriter’s counsel fees, remarketing agent fees, liquidity provider or other credit enhancement fees, bond trustee fees and bond trustee counsel fees.

In addition to the obvious purpose of lowering debt service and the costs of issuance, municipal borrowers are taking advantage of bank loan refinancings to reduce their mix of fixed and variable rate debt, to restructure debt amortization, to shed burdensome bond document covenants and to reduce liquidity risk that may exist under outstanding variable rate demand bonds (VRDBs).

For example, direct bank loans seem to have become the vehicle of choice to refinance outstanding VRBDs by effectively converting those letter of credit obligations and risks into direct loan obligations, often in refinancing transactions with the former letter of credit bank.

Such a direct loan may also be preferred by financial institution lenders over letters of credit, standby bond purchase agreements or other liquidity facilities due to the evolving capital adequacy rules and standards under Dodd-Frank (and its progeny) and because the treatment of credit-enhancement facilities remains unsettled for risk-based capital computation purposes.

Another advantage presented by direct bank loans over traditional capital market issuances is flexibility, both in negotiating credit terms and in the administration of the debt relationship going forward. A muni borrower may be able to more flexibly negotiate the terms of a borrowing by dealing one on one with a single lender rather than by negotiating with an underwriter based on what the underwriter believes to be necessary to sell the bonds in the capital markets. Further, the trust indenture that governs a borrower’s ability to issue additional debt over time may lock the municipal borrower into a fixed, common set of covenants and documentation requirements, making it potentially more difficult to address special debt needs that may arise.[2]

Flexibility in credit administration is achieved because it is much easier to obtain the consent of a single lender to modifications or waivers of credit documents than having to work through a bond trustee and DTC to locate and obtain consents from a disparate set of bondholders.

On the regulatory front, direct bank loans presently have an advantage over capital market issues involving an underwriter because the regulatory burden on the borrower is substantially reduced. With no underwriter in the deal, the bond issue is not subject to many of the regulatory compliance requirements imposed on underwriters of municipal securities by the Municipal Securities Rulemaking Board (MSRB) and the Securities and Exchange Commission (SEC). The requirements that come along with an underwritten deal include: the underwriter must obtain a continuing disclosure agreement with the municipal borrower pursuant to SEC Rule 15c2-12 and determine whether the municipal borrower is presently in compliance with all of its other continuing disclosure undertakings as a condition to selling the bonds; an official statement or placement document must be used in connection with the bond offering and filed and supplemented on the SEC’s Electronic Municipal Markets Access System (EMMA); and mandatory continuing disclosure filings must be made on EMMA by the municipal borrower.

You should be aware, however, that these so-called regulatory advantages are currently under close scrutiny by the MSRB and various other regulators. There is a growing belief by the regulators that the use of such direct bank loans creates something of a shadow market that deprives the capital markets of essential information regarding muni bond issuers, including information which would otherwise be available if an underwriter were involved in the financing.

To illustrate, the MSRB has published Notice 2012-18 that strongly urges state and local governmental issuers to voluntarily file with EMMA the same types of information and disclosures that would be applicable if the issue was publicly underwritten. Notice 2012-18 summarizes the MSRB's concerns as follows:

"The increased use by state and local governments of bank loans to meet funding needs has raised concern among market participants about the level of disclosure about such loans. Because, as described below, bank loans generally do not require the same level of disclosure as public offerings for municipal securities, holders of an issuer's outstanding debt, as well as potential investors and other market participants, may not become aware of such bank loans or their impact on the issuer's outstanding debt until the release of an issuer's audited financial statements. Thus, for example, bondholders may not be aware of the terms and conditions of a bank loan that may require the acceleration of debt repayment if the borrower encounters financial stress. In other circumstances, where bank loans are on parity with or senior to other outstanding debt, the bondholders' security position could be diluted."

Because of these expressed concerns, it would not be surprising if future legislative or administrative initiatives were to impose increased disclosure requirements on direct bank loans to municipal entities. Perhaps that is even to be expected in this era of concern for municipal market transparency and full disclosure.

Finally, the rating agencies are beginning to take a much harder look at outstanding bank debt when doing their rating analysis of municipal issuers. Standard and Poor's, in its commentary noted above, has indicated that it is concerned with the increasing use of such facilities by municipal borrowers and the liquidity and other credit risks presented by direct bank loans. According to S&P's commentary, these risks are increasing as a more diverse group of banks enters this lending arena and the terms and covenants within the bank agreements are less clearly defined and uniform. In S&P's view, this creates the potential for considerable credit risk exposure. These risks are, or will be, part of the ratings analysis and could be the basis for a negative credit action or outlook change.

In summary, direct lending to municipal entities presents a lending opportunity for Pennsylvania banks and other financial institutions that should continue until at least the current interest rate climate changes in an adverse direction. However, as these direct bank loans become even more widely used, they are moving onto the regulators' and rating agencies' radar screens in significant ways. There is no doubt more to come on these evolving fronts.

[1] Source: Standard & Poor's commentary, Alternative Financing: Disclosure is Critical to Credit Analysis in Public Finance, February 18, 2014
[2] It should be noted that for active issuers, using a uniform set of documents and covenants may provide other benefits that should not be overlooked, such as not having to comply with several different, and potentially conflicting, covenant regimes. Such an arrangement would also have the benefit of serving as a convenient vehicle for achieving parity of covenants and security among bondholders without having to negotiate and execute intercreditor agreements each time that new parity debt is issued.

7/23/2014

by Daniel Malpezzi | McNees Wallace & Nurick LLC

This article was published in the Early Summer 2014 edition of PABanker Magazine (Pennsylvania Bankers Association).

Muni Rally Pushes Yields to Lowest Since May 2013 on Supply.

Municipal bond yields fell to the lowest in 14 months as demand for state and local securities climbed ahead of a drop in issuance next week.

Interest rates on benchmark 10-year munis dropped to 2.22 percent yesterday, the lowest since May 2013. Yields have fallen about 0.22 percentage point since July 11, heading for the biggest two-week decline since January, data compiled by Bloomberg show.

States and local governments have scheduled about $3.6 billion of bond sales during the next 30 days, the least since February, Bloomberg data show. Municipalities are set to sell about $2.1 billion of long-term debt next week, down from $7.2 billion this week.

"Less supply and more demand are just driving yields down," said Dan Toboja, senior vice president of muni trading at Ziegler Capital Markets in Chicago. "It doesn't look like there's a ton of supply coming down the pike either."

The expected slowdown comes as demand in the $3.7 trillion muni market is picking up. Individual investors added about $686 million to muni mutual funds in the week ended July 23, the most since May 7, Lipper US Fund Flows data show. That compares with $158 million in inflows the prior week.

By Elizabeth Campbell Jul 25, 2014 8:08 AM PT

To contact the reporter on this story: Elizabeth Campbell in Chicago at ecampbell14@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net
Mark Schoifet

Window Closing to Challenge Wall Street Over Swaps: Bloomberg Muni Credit.

The clock is running out on a way for U.S. states and cities to try to recoup payments to Wall Street on bond deals that blew up in the financial crisis.

Six years after credit-market turmoil began hitting local governments with rising bills for bond and derivative deals that backfired, the time limit will soon lapse for issuers to seek to claw back their losses by arguing that banks misled them about the risks, said former Congressman Bradley Miller, an attorney with Grais & Ellsworth LLP in New York.

With a six-year statute of limitations closing, officials in Los Angeles may vote to press Bank of New York Mellon Corp. and Dexia SA (DEXB) to renegotiate or terminate interest-rate swaps costing $4.9 million a year. Harris County, Texas, which encompasses most of Houston, is hiring an adviser to look at whether risks were presented fairly when it entered deals that are costing about $7 million a year.

“It’s one of the things from the financial crisis that keeps reverberating,” said Houston attorney David Peterson, a partner at Susman Godfrey who has handled litigation related to the collapse of the auction-rate securities market. “Municipalities are wondering what they got in return for taking the risk. It’s the issuers who end up suffering, and at the end of the day the taxpayers who end up paying.”

The Unraveling

The costs resulted from complex financings that Wall Street banks pitched as a way to cut borrowing expenses and that unraveled after the 2008 financial crisis. States and localities have paid more than $4 billion to banks to back out of the agreements, while issuers such as Chicago and Baltimore opted to remain in the money-losing trades.

With the transactions, municipalities sold bonds with floating interest rates, then entered into related derivative contracts to protect against the risk borrowing costs would jump. Through the derivatives, municipalities received payments based on indexes such as the London interbank offered rate, or Libor, meant to cover the cost of the bonds. In return, they made fixed interest payments to the banks.

The tactic turned costly in 2008, when borrowers faced soaring interest bills as credit markets seized up. At the same time, the payments they received under the swaps fell as the Federal Reserve pushed its benchmark overnight rate close to zero.

’70s Vintage

Miller, a former North Carolina Democratic representative who sat on the House Financial Services Committee, said banks may have violated rules requiring them to deal fairly with local governments that hire them to arrange bond sales.

He said that under those rules, first put in place in the 1970s, underwriters must explain complex transactions in an understandable way and disclose the material risks. Issuers have six years to bring arbitration cases from the time they determine the deals backfired, under Financial Industry Regulatory Authority guidelines.

While issuers were told of risks of entering swaps sold along with variable-rate debt, the magnitude of what could go wrong may not have been sufficiently explained, Peterson said.

“It appears they rarely, if ever, showed how vulnerable issuers were to the variables,” said Joseph Fichera, chief executive officer of New York-based Saber Partners LLC, which is poised to be hired by Harris County. “Savings were calculated without adjusting for the risks that could affect the savings, which is a core financial principle that should have been followed.”

Uphill Fight

Public officials in cities such as Oakland have tried to pressure banks into breaking the decades-long contracts with little success. In Los Angeles, finance officials already met with at least one swap provider and were told they “will be unlikely to offer a significant discount,” according to a June 27 memo to the mayor and city council from Miguel Santana, the city administrative officer.

A last-ditch effort to fight the contracts through arbitration may also prove difficult.

Miller said he was aware of only one municipal issuer, a nonprofit insurer in Louisiana, that tried to recoup money from banks in arbitration by arguing it was misled. It lost the decision. In other cases, issuers pursued claims in court instead of arbitration, after being challenged by banks, Miller said.

"It doesn't take a very close reading of the contracts to realize that these kinds of cases are difficult to pull off," said Robert Fuller, a principal at Capital Markets Management LLC, a Hopewell, New Jersey-based swaps adviser.

Alabama Precedent

Some municipalities may find a road map in a case settled by an Alabama sewer company. In March, Baldwin County Sewer Services LLC was able to recover losses after an arbitration panel ruled that a failed swap deal amounted to "a continuing but hidden fraud." Arbitrators told Birmingham-based Regions Financial Corp. (RF) to pay $7.4 million, the net amount of swaps payments the utility made.

Katrina Cavalli, spokeswoman for the Securities Industry and Financial Markets Association, which represents banks that underwrite municipal securities and in some cases serve as counterparties for swaps, declined to comment in an e-mail.

In Los Angeles, the challenge to the city's swap deals is being led by Councilman Paul Koretz, who filed an ordinance that may be considered after the council's recess ends later this month.

Bank Expenses

His proposal was in response to a report by the Fix LA coalition. The group, which includes local labor unions and community groups, found that the city spent $204 million on bank fees in 2013, including swap payments, investment-management fees, the cost of bond insurance and remarketing fees, letters of credit and service fees. That year, Los Angeles spent $163 million on streets, the report said.

Paul Neuman, a spokesman for Koretz, said the swaps have been a drain on the city as it pushed through budget cuts in the recession's aftermath.

"It is a shame that some financial institutions are benefiting when we face such difficulties, especially when we followed their advice," he said in an e-mail.

Kevin Heine, a Bank of New York Mellon spokesman, declined to comment on the measure. Phone messages left after business hours at the Brussels and Paris press offices of Dexia, as well as e-mails to the bank's press address, weren't returned.

In Harris County, Treasurer Orlando Sanchez said he's hiring Saber Partners to review swaps and decide whether the county should pursue an arbitration claim. The county will have paid about $31 million to Citibank from 2010 to 2014, according to county documents, plus $19 million in interest on the bonds to which the swaps are attached.

Scott Helfman, spokesman for New York-based Citigroup Inc., declined to comment.

"We need to get to the bottom of what happened with our swaps," said Sanchez. "I want an independent set of eyeballs to look at it."

By Darrell Preston Jul 24, 2014 5:00 PM PT

To contact the reporter on this story: Darrell Preston in Dallas at dpreston@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net William Selway, Mark Tannenbaum

---

[MSRB to Make Kroll Bond Ratings Available to the Public Through its EMMA Website.]

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) announced today that it plans to provide free public access on its [Electronic Municipal Market Access (EMMA®) website] to public finance ratings from Kroll Bond Rating Agency (KBRA).

"The addition of KBRA credit ratings to EMMA gives investors yet another tool to make more informed decisions about municipal bonds," said MSRB Executive Director Lynnette Kelly. "The MSRB welcomes KBRA's participation and support of EMMA's goal to enhance access to municipal market information."

The MSRB began providing ratings from Fitch Ratings and Standard & Poor's on EMMA in 2011. [Read more about the ratings information currently available on EMMA.] Ratings information from KBRA will become available this fall.

KBRA, Standard & Poor's and Fitch are registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (NRSRO). The MSRB has invited all NRSROs to provide their municipal credit ratings on EMMA.

The EMMA website is the official repository for information on virtually all municipal securities. EMMA provides free public access to official disclosures, trade data, credit ratings, educational materials and other information about the municipal securities market.

[Has S&P Been Exaggerating Local Governments' Stability?]

One analyst says the new way the credit rating agency scores local governments downplays the risk investors are taking and could encourage ratings shopping.

Since last fall, when S&P released new scoring criteria, the agency has been reassessing ratings for thousands of local governments. Generally, and as predicted by S&P itself, the new criteria resulted in more upgrades of governments than downgrades. But a Janney Montgomery Scott analyst pointed out in his July note on the bond market that those changes have not put S&P's ratings more in line with competitors Moody's Investors Service and Fitch Ratings.

In some cases, rather, agencies' ratings scores for the same local governments have diverged even more.

"I do not remember a time when I saw so many credits with not just a one-or-so-notch difference here and there, but multiple-notch differences in some cases," said Tom Kozlik, the analyst who wrote the note. "This is not part of the typical ratings cycle (where sometimes one rating agency is a little higher and vice versa, I suspect). As a result, I expect that rating shopping could be on the rise if the current trend continues."

Ratings shopping, where a government issuer chooses to publish just its highest credit agency rating, came under scrutiny in the aftermath of the financial crisis but the focus from regulators and investors was on the rosy ratings from all credit agencies assigned to mortgage-backed-securities. According to Kozlik, however, investors should bring similar skepticism to S&P's ratings of local governments. "In other words," he wrote, "we do not think that some of S&P's ratings reflect the risk investors are taking."

Jeff Previdi, the S&P managing director for local governments who spearheaded the agency's criteria change, defended the process. He said that the criteria had been heavily tested and had gone through a public comment period. The [new criteria] scores municipalities in seven categories: management, economy, budgetary flexibility, institutional framework (governance), budgetary performance, liquidity and debt/liabilities. The score for economy counts for 30 percent of the total score; all other categories are given a 10 percent weight.

The intent was to make the process and scoring as transparent as possible, Previdi said. Additionally, he added, the upgrades have tended to outpace downgrades for a very simple reason: Governments are doing better now than when they were last assessed.

"When we are reviewing under the new criteria, we're not working with the same metrics of the old criteria," he said. "It's not done in a vacuum. Over this time we've been in a generally positive environment for local governments — that's informing some of the results you see."

Even so, Kozlik noted in his report that there has been a pattern of governments only publishing an S&P rating. In June, for example, there were a little more than 200 local governments that sold debt competitively. Of those, one-quarter of them only published an S&P rating, according to Kozlik's review. Another 11 governments only published an S&P rating but also had an outstanding Moody's rating within the past three years (Kozlik dismisses 16 cases where the outstanding Moody's rating is prior to 2011). Like S&P, Moody's has also revamped its [ratings criteria] in the wake of the financial crisis, however changes have mostly focused on giving pension and other long-term liabilities more weight in the final score. Most local government pension liabilities shot up during the financial crisis and many have still not gained back much – if any – ground. This change has contributed to Moody's issuing more downgrades.

Kozlik also took issue with S&P's assessment that the economy has significantly improved for local governments. Earlier this year, Janney released a report calling for a cautious outlook for local governments based on stagnating revenues that are not keeping pace with demands. "Sure, in some cases a year or two can make a significant difference in municipal credit quality." he said. "I also think that there are too many [cases] for timing to be a key factor in explaining the trend."

He concludes the note by advising investors that own a bond with only an S&P rating, to review the credit themselves and check to see if it also has a Moody's rating. Moody's has been issuing about twice as many downgrades as it has upgrades, "a trend that makes sense to us," Kozlik wrote, "because we are still seeing mostly difficult credit conditions pressure local governments."

GOVERNING.COM
BY LIZ FARMER | JULY 16, 2014

[Finding the Money for Water Infrastructure.]

A new federal loan program, patterned after a successful one for transportation, has a lot

of potential for badly needed water projects.

Enhancing the nation’s water infrastructure remains a challenge for public officials as they balance the need for improvements against constrained budgets. The recently enacted federal Water Resources Reform and Development Act has the potential to advance the nation’s water infrastructure by streamlining approvals for environmental reviews of projects, creating a pilot program to explore the use of public-private partnerships by the U.S. Army Corps of Engineers, and making it easier to leverage private-sector investments to augment public funding.

As officials contemplate how they will finance water infrastructure improvements, one provision in the law, the newly created Water Infrastructure Finance and Innovation Act (WIFIA) loan program, is of particular interest.

Co-administered by the Environmental Protection Agency (EPA) and the Army Corps, WIFIA will provide secured loans and loan guarantees to both government and non-government entities for up to 49 percent of eligible project costs. WIFIA is patterned after a highly successful federal loan program for transportation projects called the Transportation Infrastructure Finance and Innovation Act (TIFIA), which has provided $17 billion in federal credit assistance and spurred approximately $64 billion in total project investment since its inception in 1998.

I believe state and local government agencies, drawing on the lessons from TIFIA, could employ WIFIA to take the first small steps toward addressing badly needed water infrastructure improvements.

There are important details to consider. Projects financed through WIFIA must exceed $20 million in total cost and must be deemed creditworthy by EPA or the Army Corps. In addition, the projects must be rated as investment-grade by at least one rating agency. Like TIFIA loans, interest rates under WIFIA are tied to U.S. Treasury bond rates, and maximum loan repayment periods of 35 years and a five-year repayment deferral after substantial completion are allowed. This pricing approach and the repayment flexibility are major reasons for the success of the TIFIA program.

The total five-year appropriation for WIFIA is $350 million, equally split between EPA and the Army Corps, beginning with $40 million in 2015. This represents the credit subsidy available for qualified projects, not the total amount of financing available. The credit risk of each WIFIA loan application will be “scored” by the Office of Management and Budget, and these credit-subsidy amounts will then be paid out of the authorized funding available.

While WIFIA provides a welcome additional source of financing for water projects, a number of challenges remain. The administrative roles of EPA and the Army Corps and their respective application procedures have yet to be fully fleshed out. Coordination between the agencies might also be challenging, and with limited funding for program administration, prospective borrowers should anticipate a slow process initially as the two agencies ramp up their activities. Of greatest concern is the modest level of program funding, which will not have a material effect on the enormous investment backlog in the water sector.

Public officials should draw on the lessons learned from TIFIA’s evolution and be prepared initially to face administrative and procedural challenges while EPA and the Army Corps develop internal capabilities and implementation procedures. Understanding and anticipating federal requirements will be critical to securing WIFIA commitments, and prospective borrowers will need to be patient.

Another lesson from TIFIA is that successful WIFIA project financings could dramatically increase market demand for credit assistance and might lead to increased political support for the program.

As TIFIA-financed projects began to positively impact the market, Congress ramped up funding and adopted changes to help the Department of Transportation streamline the program. Initial WIFIA successes will be critical to the program's long-term viability.

The potential impact of WIFIA on the U.S. water and wastewater market is being closely tracked by the industry, and public officials will likely begin to see increasing interest from private operators and investors. Public water utility officials would be wise to not only become familiar with WIFIA but to study the nuances of TIFIA and how it became the program it is today.

GOVERNING.COM
BY ED CROOKS | JULY 21, 2014

The Decoupling Of Treasury Yields and the Cost of Equity for Public Utilities.

Anyone who has attended a rate case hearing recently is well aware that the debate over the rate of return now tends to focus on the implications for public utility investors of a largely unprecedented trend in the current capital markets—specifically, intervention by the Federal Reserve in the government bond market. The current capital market conditions are unique from a historical perspective. No US government policy intervention in recent history has had such an important effect on the risk-free rate relied upon by public utility analysts in their routine modeling of market and utility investor behavior. This briefing note examines how these capital market conditions affect the cost of capital for electric and gas utilities.

A key question within this debate is whether the historic risk premium required by equity investors to invest in stocks remains accurate in today's capital market conditions. Financial analysts have often relied upon the historic equity risk premium for use in estimating required rates of return in models like the Capital Asset Pricing Model. The calculation of the historic premium measures the difference in expected return as between the S&P 500 index and long-term US treasury bonds. For example, if on average the historic S&P 500 return were 12% annually, while long-term treasury bonds yielded 5%, then the historic risk premium required by equity investors would be deemed to be 7%. Financial analysts typically use over eighty years of data when assessing the historic premium, thus capturing a wide variety of conditions in the capital markets. In recent years, the historic premium has fallen within the range of 6 to 7 percent.

Current capital market conditions raise doubts about whether the risk premium, measured using historical data, is applicable today. The doubts arise as analysts attempt to answer key questions. How have equity investors responded to the artificial reduction in treasury yields triggered by the Federal Reserve's bond buying program? Have they lowered their total return expectation as rapidly as treasury yields have fallen? Rate-of-return models that rely upon the historical premium assume that investors' total return expectations move in lock step with treasury yields. Hence, if the historic premium is still valid, it implies a significant decrease in required returns on equity for both industrial firms and public utilities.

NERA's empirical investigations in recent rate cases show that the historical premium has not been a good measure of the forward-looking premium required by investors. The spread between the risk-free rate and the required returns for holding equities has broadened as the Federal Reserve has aggressively acted to keep interest rates at record lows and stimulate the economy. For public utilities, this is reflected in a relatively stable awarding of allowed returns in the context of a rapid decline in treasury yields, the market's metric of the "risk-free" rate. As shown in Table 1 below, since 2006, the average allowed return for electric utilities has hovered in the range of 10.0 to 10.5 percent, while treasury yields fell 200 basis points and then started to recover. If the market risk premium had been unchanged during this period, the allowed returns—which themselves are based on the capital market data put forth by public utilities and intervenors alike—would have declined as precipitously as the treasury yields did. They did not. A constant historical equity risk premium ignores the elevated cost of holding risky securities relative to the riskless security benchmark. A forward-looking premium thus provides the most accurate gauge of investor demands in the current market environment where required returns on equities have decoupled from treasury yields.

Table 1.

Year	Treasury Yield (30-year)[A]	Electric Utility Allowed ROE[B]
2006	4.91	10.32
2007	4.84	10.30
2008	4.28	10.41
2009	4.08	10.52
2010	4.25	10.37
2011	3.91	10.29
2012	2.92	10.17
2013	3.45	10.02

Notes:
[A] Treasury yields obtained from the Federal Reserve's h15 release.
[B] Allowed returns obtained from Regulatory Research Associates, a division of SNL Energy.

NERA estimates the forward-looking risk premium using the well-established dividend growth model. This model offers an estimate of the total return required by equity investors, derived from two principal inputs: 1) the dividend yield and 2) profit growth rate. Once armed with the total expected return, NERA subtracts the current government bond yield to arrive at the implied equity risk premium. This approach has the advantage that it incorporates the most recent information from capital markets and thus is most consistent with the intent of any cost of equity calculation, which is to reflect current forward-looking expectations.

In its most recent analysis, NERA found the forward-looking risk premium to be 8.36 percent, which compares to a historic risk premium of 6.70 percent, a difference of 166 basis points. This shows that the use of a historic risk premium would significantly understate the cost of equity for utilities. While the observed equity risk premium does not translate on a one-for-one basis to a required return for utilities—utility betas are often below one—it does signal the scale of the disconnect between historic conditions and those prevailing today.

It is not surprising that the market's reaction to the policy-driven interest rate drop has been a higher required return for riskier assets. Market-driven events have led to similar outcomes. For example, in past "flight to quality" situations, the yields on riskier bonds and required returns on equities have crept higher as yields on government bonds and high-rated corporates declined.1 In addition, academic studies assessing the risk premium over time have shown a negative relationship between risk premia and interest rates.2

State regulators implicitly recognize the higher equity risk premium that prevails in today's market. They do so by approving rates-of-return that contain a higher premium over government bond yields than has historically prevailed. (See Table 1 above.) For its part, the Federal Energy Regulatory Commission (FERC) explicitly acknowledged, in its ruling in Docket No. ER14-500-000, that the "current low treasury bond rate environment creates a need to adjust the CAPM results, consistent with the financial theory that the equity risk premium exceeds the long-term average when long-term US Treasury bond rates are lower than average, and vice-versa."

Whether the change in premium is reflected by adjusting the model results on an ex post basis, as was done in the FERC docket, or to the model inputs on an ex ante basis, as NERA has done in recent state dockets, is not so important. Most important is making sure that the rate of return somehow incorporates the current forward-looking investor expectations and does not rely solely upon unadjusted historic expectations.

NERA's Role in Cost of Capital Determinations

Prices in regulated industries rely upon costs, which include the cost of capital as a core component. NERA has been at the forefront of issues concerning the cost of capital for regulated industries for nearly 50 years—ever since Alfred Kahn devoted an Appendix in his great work, The Economics of Regulation, to NERA's Herman Roseman's cost of capital work in the 1960s.

Utility businesses have changed drastically over those 50 years, in structure, ownership, pricing, and competitiveness. Throughout all of these changes, regulation has continued to play a key role in the protection of consumers who buy from the remaining "natural" monopolies—local distribution in gas and water, transmission and distribution in electricity, and local service in telecommunications. For these regulated businesses around the world, the cost of capital remains an enduring issue—the base of regulated prices and a continuing subject of debate, concern, and empirical investigation—in which NERA continues to play a key part.

Footnotes

1. The autumn of 1998 is one such example.

2. See W. Carleton, W. Chambers and J. Lakonishok, "Inflation Risk and Regulatory Lag," Journal of Finance, (May 1983). A similar approach is presented in R. Harris, "Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return," Financial Management (Spring 1986).

July 15 2014
Article by Kurt G. Strunk
NERA Economic Consulting

[S&P Credit FAQ: Bond Insurers and the Recent Downgrades of Puerto Rico's Public Corporations.]

The recent credit deterioration of Puerto Rico's public corporations and enactment of legislation that would enable some of the entities to restructure their debt have prompted investor questions on the potential impact on bond insurer ratings. (See also "Puerto Rico GO Rating Lowered One Notch To 'BB' Following Debt Legislation; Outlook Negative," published July 11, 2014.) Below Standard & Poor's Ratings Services provides answers to the most frequently asked questions.

Continue Reading.

S&P: How Asset-Backed Contribution Arrangements Can Muddle Pension Deficit Reporting.

(Editor's note: The opinions stated herein represent Standard & Poor's Ratings Services' views on the analytical consequences of financial reporting of asset-backed contribution schemes. Our comments in this article do not affect our current ratings criteria.)

Postretirement plans with asset-backed contribution (ABC) arrangements have come under various criticisms in the U.K. Last year, the U.K. Pensions Regulator warned trustees to "critically and carefully" evaluate the risks attached to these increasingly popular arrangements, which are essentially securitizations of assets that provide annual income stream to the pension plan (see the Appendix for an overview of ABC arrangements and the related accounting). And in a recent public announcement, the U.K.'s Financial Reporting Council (FRC) promised a crackdown on arrangements that resulted in companies removing their postretirement obligations from their balance sheets (or "derecognizing" them) while retaining the ultimate responsibility for the unfunded deficit.

The FRC investigated the accounting and financial reporting of a number of ABC arrangements. While acknowledging the existence of the arrangements in general, noting the commercial reason behind them, it criticized structures that introduced additional features with the sole purpose of transforming the pension obligations into equity instruments in the sponsoring entity's consolidated financial statements. Standard & Poor's Ratings Services agrees with the FRC that the economic substance of these arrangements is that of a debtlike liability rather than an equity instrument, because the companies would eventually need to contribute to the pension plan's deficit if the ABC structure fails to do so.

Continue Reading.

S&P: U.S. Pension Funding Improves, But How Long Will It Last?

The good news is that Americans are generally living longer and healthier lives, but the bad news is that retirees will be increasingly hard-pressed to afford their own longevity, either individually or through their employers. The budgetary pressures on Medicare, Social Security, and many state-funded employee pension plans will likely mount as more baby boomers retire, while the boomers themselves fear that their retirement savings will be eaten up by inflation, depleted by poor investment performance—or just plain give out before they do. Moreover, an extended period of lackluster economic growth could depress tax revenues and investment returns. Clearly, more retirees and less money to pay for their care does not add up.

While the big fear is that the U.S. will come to resemble Japan, a nation struggling to support an increasingly older population in a somnolent economy, Standard & Poor's Ratings Services believes the public and private sectors in the U.S. are slowly coming to terms with this incipient pension and retirement crisis. Across all sectors, pension funding benefited from strong stock market performance in 2013 and a healthier economy, which boosted overall tax revenues. How long such buoyant market returns will continue is anyone's guess, but if capital markets flourish and the economy grows, we expect more robust pension funding.

Continue Reading.

Investment Center to be a “One-Stop Shop” for P3S According to White House.

As part of a larger package aimed at building private infrastructure investment, President Obama on Thursday unveiled the Build America Transportation Investment Center, a “one-stop shop for state and local governments” seeking guidance on developing public-private partnerships for transportation projects.

“First-class infrastructure attracts investment, and it creates first-class jobs,” Obama said in announcing the Center’s creation during a visit to the Port of Wilmington, Del. The I- 495 bridge across the Christina River, which was closed in June after engineers discovered it was structurally unsound, served as the backdrop for the public appearance.

The new center will provide a “navigator service,” allowing experts to provide hands-on support to the public and private sector to identify and execute successful P3s and share best practices from states that are leading the way on private investment, according to a fact sheet released by the White House.

The Department of Transportation, which will run the center, will encourage the use of existing DOT resources – including the Transportation Infrastructure Finance and Innovation Act (TIFIA) program, private activity bonds and the railroad rehabilitation and improvement financing program – that can improve the prospects for a P3 to become viable.

Transportation Secretary Anthony Foxx expressed his hope that local and state leaders would use the new resources provided by the investment center. “We have a huge opportunity in front of us if we just seize it,” Foxx said. The White House noted that the top six states for P3s command two-thirds of the value of P3s in the U.S. and twenty states have not P3s for any transportation infrastructure.

“None of the steps we are taking should be seen as a substitute for adequate public financing, because there isn’t a substitute for that,” Foxx told reporters in a conference call, reported the New York Times.

The center grows out of a presidential memorandum launching the Build America Investment Initiative and charges Transportation Secretary Anthony Foxx and Treasury Secretary Jack Lew with overseeing a task force aimed at reducing barriers to private investment in municipal water, ports, harbors, broadband and the electric grid infrastructure, reported the Washington Post.

NCPPP
By Editor July 18, 2014

MMA Municipal Issuer Brief - July 14, 2014

Read the Brief.

California Water Use Curbs a Credit Negative, Moody’s.

The new restrictions on water use California approved this week are a “credit negative” for the state’s water utilities because lower water sales will reduce their revenue, Moody’s Investors Service said.

A decline in water sales would pressure utilities with weak debt service coverage to increase rates to stabilize revenues, Moody’s said today in a research note.

“The prospect of charging customers more to deliver less water could be politically challenging,” Moody’s said.

The California State Water Resources Control Board this week approved emergency statewide rules that take effect on Aug. 1. They impose a fine of as much as $500 per day on property owners who overwater lawns so that runoff flows onto streets and those who wash cars with hoses that lack shutoff nozzles.

After three years of record-low rainfall, 80 percent of the most populous U.S. state is now experiencing extreme drought, according to the U.S. Drought Monitor, a federal website.

By Alison Vekshin Jul 17, 2014 4:04 PM PT

To contact the reporter on this story: Alison Vekshin in San Francisco at avekshin@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Jeffrey Taylor, Michael B. Marois

---

Moody's: Detroit's Current Plan of Adjustment Favors Pensioners over Bondholders.

New York, July 17, 2014 — Under Detroit’s proposed plan of adjustment, recovery rates are likely to favor pensioners over bondholders, says Moody’s Investors Service. In the report “Detroit’s Proposal Favors Pensioners over Bondholders” Moody’s estimates the recovery on the unfunded portion of the city’s pension liabilities could reach 52%, which would likely exceed the recoveries on other unsecured claims.

Recoveries on unfunded pension liabilities, however, could be as low as 18% should the proposed special pension funding deal fall through. The recoveries on certificates of participation issued to fund pensions could be as low as 0% should the bankruptcy court allow the city to repudiate them.

Moody’s says pension recoveries as measured by aggregate liabilities, that is both funded and unfunded pension claims, could reach 82%, higher than 74% settlement announced for general obligation unlimited tax, or GOULT, bonds.

“The proposed plan of adjustment provides evidence that pension obligations are a substantial source of competition among creditors in Chapter 9 bankruptcy,” says Moody’s Assistant Vice President Tom Aaron.

Under the proposed plan, recoveries for pensioners get a boost from numerous sources, including dedicated outside funding and some contingent restoration of benefits. For example, state and privately donated funds exceeding $800 million over 20 years nearly triples the recovery rate. These funds would be in return for shielding the city's art collection from creditors' claims and for pensioners accepting the plan.

Detroit's plan of adjustment calls for a number of reductions to pension benefits that affect both current employees and retirees. If pensioners do not vote to accept the proposal, outside funding is not available, or both, then the benefit reductions proposed in the plan of adjustment become more severe.

Moody's notes Detroit assumes significant risk by taking on responsibility for any unfunded pension liability after 2023. Moody's estimates of unfunded pension liabilities after benefit reductions range as high as $1.6 billion, using the city's assumptions. However, the liability remains highly influenced by the assumptions used in its calculation.

For more information, Moody's research subscribers can access this report at

https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_PBM172662

Fitch: Few Surprises for Bondholders In Detroit LTGO Settlement.

Fitch Ratings-Chicago/New York-14 July 2014: Detroit's settlement with its limited tax general obligation (LTGO) bondholders is in line with Fitch Rating's expectations.

The settlement would repay the LTGO bondholders without a lien on state aid 34 cents on the dollar. That exceeds earlier offers of 10-20%. A previous settlement agreement provides for ULTGO bondholder recovery of 74 cents on the dollar and includes a clause requiring LTGO bondholders (and other classes of impaired unsecured creditors) to receive lower recovery. The city has $164 million of LTGOs without a lien on state aid and $379 million of LTGOs with a state aid lien. A court will begin hearing the plan of confirmation on August 14.

Detroit's treatment of LTGO and other bondholders strains the boundaries of what most creditors would have expected to be entitled to in a bankruptcy.

Fitch expects situations like Detroit's to continue to be rare as few governments are as severely stressed as and there is a long-demonstrated willingness of most municipal governments to avoid default and bankruptcy. Also, the nation's slow economic recovery has begun to lessen the financial stress on many other issuers.

Contact:

Amy Laskey
Managing Director
U.S. Public Finance
+ 1 212 908-0568
33 Whitehall Street
New York, NY

Rob Rowan
Senior Director
Fitch Wire

+1 212 908-9159

WSJ: Bond Insurer Takes On Detroit.

DETROIT—Detroit expected a bruising battle with everyone from major banks to municipal unions when it filed its bankruptcy case last year.

But its most persistent adversary has turned out to be a scrappy bond insurer that represents just 5% of the city's debt.

New York-based Syncora Guarantee Inc., with about $400 million at stake, has attempted to block the city's access to casino-tax revenue, new borrowing to repair streetlights and the city's settlement with two major banks. It has sought decades of records from foundations trying to help save the city's art collection, and complained to the judge when it was linked to a statement by the city's emergency manager about the "Huns of Wall Street."

Six bond insurers are the city's biggest creditors after backing payments on $6.1 billion of Detroit's debt, according to a March report by Raymond James.

When a municipality defaults on insured bonds, the insurer becomes responsible for interest and principal payments to bondholders, then tries to recover as much of those payouts as possible from the debtor.

Now, Syncora insists the city's debt-cutting and reinvestment plan aimed at restructuring originally pegged at about $18 billion in long-term obligations unfairly offers modest cuts to its pensioners and much more severe cuts to some bondholders backstopped by insurers like Syncora. A federal trial in bankruptcy court on the plan is scheduled for mid-August.

Voting on the city's plan ended Friday for 70,000 creditors, including 32,000 pension holders. The city expects to announce the results no later than July 21, officials said. According to a person familiar with the matter, city officials are cautiously optimistic that pension holders have approved Detroit's debt-cutting plan.

The plan will help the city shed roughly $7 billion in debt and leave it with about $1.4 billion to reinvest in city services and blight removal, says an internal report from the investment-banking firm Miller Buckfire & Co. released by the city.

Syncora has also helped push for monetizing the Detroit Institute of Arts collection through a possible sale or lease to help repay city debt. It essentially rejects the city's proposal to allow outside donors to contribute the equivalent of more than $800 million over 20 years to reduce pension cuts and allow the museum to stay intact.

"We think this is about us getting as much recovery as we can and getting similar recovery to other similarly situated creditors like the pensioners and retirees," James Sprayregen, a Kirkland & Ellis attorney in charge of Syncora's Detroit case, said. "But from the get-go for whatever reason, we have been vilified as the big bad Wall Street creditor against the little people. And we think that's very inappropriate and unfair."

City officials say Syncora has filed a flurry of legal arguments in an attempt to grind the bankruptcy process to a halt. At various times, the city has called Syncora's methods "scorched earth litigation strategy," as well as a "carpet-bombing approach."

"It's safe to say they have employed a kitchen sink strategy with all of their objections," said Bill Nowling, a spokesman for Detroit Emergency Manager Kevyn Orr. "All that does is add more work for the judge and more delay for the confirmation of the plan."

Detroit has reached settlements with several other insurers with deals better than what is called for in the city's plan for Syncora. For example, the city would pay limited-tax general-obligation bondholders about 34 cents on the dollar for their $164 million in debt. That debt is backed by Ambac Assurance Corp. and BlackRock Inc., according to city documents.

But Syncora's estimated $400 million at stake stems largely from guaranteed payments on a $1.4 billion debt deal engineered in 2005 by then-Detroit Mayor Kwame Kilpatrick that the city is trying to completely wipe out. Company financial reports and legal filings warn that paying up on insured bondholders in Detroit could help push Syncora out of business because the city is offering less than 10 cents on the dollar. So far, Syncora already has paid $62 million to cover losses in Detroit debt through last year, according to the company.

The stock price of its parent company, Syncora Holdings Ltd., closed at $1.99 and the firm has cautioned that Detroit's bankruptcy plan could exhaust its reserves to pay out claims. "They're at a tipping point," said Peter Delahunt, managing director for the municipal-bond department at Raymond James.

James Spiotto, an expert in Chapter 9 municipal bankruptcy with Chapman Strategic Advisors in Chicago, said that Syncora raised potentially important issues about whether a city should be able to sell debt to pay pensions and say afterward that the deal was legally flawed but keep the money. "The city got a benefit from it," Mr. Spiotto said.

By MATTHEW DOLAN
July 14, 2014

—Katy Stech and Aaron Kuriloff contributed to this article.

Muni Strength to Continue in Second Half: Analysts.

The second half of 2014 promises more positive returns for municipal bonds even as investors react to declining credit quality in Puerto Rico, according to midyear analyst reports.

Based on the trends in the first six months, demand is forecast to be strong to steady while new supply is expected to lag behind redemptions, providing support for muni prices. Experts are predicting modest interest-rate increases, based on statements from the Federal Reserve, and see volume of roughly $300 billion for the calendar year.

"June was a fairly active month in terms of municipal bond issuance and headlines, yet the market ended close to unchanged," wrote Peter Hayes, head of the municipal bonds group at BlackRock Inc., with fellow authors James Schwartz, head of municipal credit research and municipal strategist Sean Carney, in a monthly municipal update on July 7.

"Municipals essentially ended [June] flat, but hit the mid-year point emphatically in the black," the BlackRock analysts wrote, noting that the S&P Municipal Bond Index posted a year-to-date return of

6.08%.

“Demand held firm while the net-negative supply scenario remained intact, underpinning muni pricing,” they added. Net negative supply occurs when redemptions outpace new issuance.

Issuance for June was $34 billion, which BlackRock said is consistent with the five-year average for the month and was up 32% from the prior month.

Municipal performance was buoyed by weak U.S. economic data – first quarter gross domestic product growth was revised downward to negative 2.9% ¬ and “a still-accommodative Fed,” the BlackRock analysts wrote.

The team said municipals are on pace for $300 billion in total issuance for 2014, in line with the firm’s earlier forecast of $305 billion. That volume implies a net-negative supply of $40 billion.

Other positives in the first half included triple-A-rated municipals outperforming U.S. Treasuries across the yield curve, with the ratio ending the second quarter at 98%, down from 102% at the start of the quarter, analysts from Prudential’s fixed income team noted in a third quarter outlook published on July 8.

Brian Rehling, chief fixed income strategist at Wells Fargo Advisors, pointed to the Bank of America-Merrill Lynch Municipal Master Index, which returned 5.90% at the close of the first quarter, as evidence of the market’s strength in his July 8 weekly fixed income report.

He said the longer duration inherent in the municipal market and a favorable supply calendar led to the tax-exempt market posting strong returns in the first half of the year, despite some isolated credit events.

Puerto Rico and Detroit were the most attention-grabbing stories of the first half, yet the market took them in stride, muni analysts said.

“It was notable that municipal investors were able to look past both the downgrade of Puerto Rico, which took the high-profile credit below investment grade, and the bankruptcy in Detroit,” Rehling said in his report.

More recent developments in the U.S. territory, including a new law allowing public corporations to restructure their debt, have the potential to undercut muni demand.

“Multiple downgrades for various Puerto Rico credits and the significant sell-off could lead to mutual fund outflows following a six-month period of moderately positive flows into municipal funds,” the Prudential analysts wrote.

“While a range-bound interest rate environment should be supportive of modestly positive fund flows,” they added, “the negative returns and headlines associated with Puerto Rico could upset this picture.”

Roosevelt D. Bowman, senior fixed income analyst at U.S. Bank Wealth Management said in a weekly market update on Wednesday that investor sentiment towards Puerto Rico “continued to sour as government officials proposed a restructuring of some debt issues.

“We remain very wary of Puerto Rican fixed income as a faltering economy, the associated sluggish tax revenue, and budget challenges all continue to weigh on the commonwealth,” Bowman wrote.

The forecast ahead, however, is mostly favorable for munis, the analysts said.

Rehling expects overall muni credit to continue to outperform as it did in the first half and suggests investors own bonds for stability, avoid reaching for yield, and maintain portfolio diversification.

"During 2014's second half, we expect interest rates to move modestly higher from current levels, but anticipate that any increases will be well-contained," Rehling wrote.

"A controlled rising rate environment should allow fixed income investors to generate positive returns, albeit lower than experienced in past year," Rehling said, suggesting an average annual total return of between 2% and 4% for well-diversified, domestic, investment-grade, fixed-income investors.

Anthony Valeri, investment strategist at LPL Financial suggests staying defensive to curtail the impact on municipals from rising interest rates going forward.

"Among high-quality bonds, shorter-term bonds with less sensitivity to rising interest rates may help buffer fixed income portfolios from price declines associated with rising interest rates," Valeri wrote in his July 3 fixed-income mid-year outlook.

At Prudential, the fixed income team believes the municipal market continues to provide attractive taxable-equivalent yields for individuals in the top tax bracket, and regard near-term technical factors, such as net supply, as "extremely supportive."

Prudential analysts cited research from JPMorgan that estimates net supply of negative $21 billion for July and August, and net supply of negative $35.4 billion in 2014, with a full year gross issuance estimated at $300 to $310 billion.

BlackRock believes performance in the second half is likely to be derived from security selection and the ability to rotate between sectors and adjust duration as conditions warrant.

"We expect this will be particularly important as summer apathy sets in and as events in Puerto Rico evolve, potentially presenting opportunities to capture value in the market," the BlackRock analysts wrote.

In the meantime, the team is recommending a barbell approach to both credit and the yield curve, favoring maturities below two years for trading flexibility and above 15 years.

"While short-term and intermediate munis are looking expensive, longer maturities continue to appear attractive versus Treasuries and, we believe, represent the best absolute and relative value."

The Bond Buyer
BY CHRISTINE ALBANO
JUL 10, 2014 2:46pm ET

The Not-So-Sunny Side of Pension Obligation Bonds.

Some governments, particularly those with money problems, borrow to quickly pay down their pension obligations. But a new study shows it can leave them more financially vulnerable.

A tool that some governments have used to immediately pay down their pension obligations through borrowing can leave those governments more financially vulnerable than they were before, a new study says.

The tool, called Pension Obligation Bonds (commonly referred to as POBs), allows governments to issue taxable bonds for the purposes of putting money toward or fully paying off the unfunded portion of a pension liability. The proceeds from the bond issue go in the pension fund. The theory is that the rate of return on the investment will be greater than the interest rate the government pays to bond investors so that the transaction is favorable to the government; it makes money off the deal.

In actuality, however, a study issued in July by Boston College's Center for Retirement Research found that the stock market and interest rate swings have meant that many governments have paid dearly for issuing POBs, especially those that issued bonds in the mid-2000s or early 1990s. And, because financially distressed governments are more likely to issue the bonds, the results often mean even more financial problems.

The report noted that the governments more likely to issue POBs are ones that have pension plans that represent "substantial obligations." The governments have large outstanding debt and are short of cash. However, rather than necessarily relieving such governments of financial pressures, the bonds actually create a more rigid financial environment. Issuing bond debt to pay off a long-term obligation like a pension liability turns a somewhat flexible pension obligation into a hard and fast annual debt payment. Thus, "governments that have issued a POB have reduced their financial flexibility," the study says.

The governments of Illinois, California and New Jersey have been very active in issuing POBs over the last three decades, according to the report, which converted totals to 2013 dollars. Illinois and California have each issued more than $25 billion total, although more than $10 billion of Illinois' bonds have been issued after the stock market began rebounding in 2009. New Jersey has issued more than $11 billion in POBs since 1985. Yet the states still stand out as having some of the nation's highest unfunded liabilities. Illinois in particular has one of the country's worst funded ratios (less than 40 percent of its public employee pension system is funded). New Jersey and Illinois (and up until recently, California) have also continued to struggle with balancing their budgets, even after the recession ended in 2009.

POBs' net returns (what the investment has earns after making bond payments) has varied, depending on when the bonds were issued. According to the center's research, the net rate of return has averaged in the low, single digits for most years (the 30-year average is 1.5 percent). Governments that issued Pension Obligation Bonds in 1998, 1999, 2000 and 2007 actually lost money on their investment. Detroit, for example, issued debt at the peak of the market in the mid-2000s to fund its pension plan and did so using a complicated interest rate swap deal. The result was that the deal went the wrong way for the city. Detroit was still on the hook to pay bondholders and though its pension was well funded, it had even less day-to-day cash to meet its financial obligations. That debt played a key role in Detroit's decision to file for bankruptcy last July.

The authors said that POBs do have the potential to be used responsibly — that is, "by fiscally sound governments who understand the risks involved or could play a role as part of a broader system reform package." For example, in 2002 and 2003, Sheboygan County and Winnebago County in Wisconsin borrowed more than $7 million combined and earned investment returns greater than 20 percent on the borrowed money. Meanwhile, they paid less than three percent interest on their debts so earned an extra 17 percent return as a reward for taking on additional risk. But, such examples such are few and far between.

Governing.com
BY LIZ FARMER | JULY 8, 2014

Retirees Win Big in Illinois.

An Illinois Supreme Court ruling this month that overturned the state's effort to cut retiree health care costs casts doubt on Illinois' pending pension reform. This could potentially hurt its credit rating, a new note by Moody's Investors Service said. In a note released July 11, Moody's placed the state's credit rating on a negative watch and said that the majority of the justices "expressed views that run counter to the rationale used in recent pension reform legislation for certain city and state plans. We therefore perceive increased risk that the Illinois Supreme Court will rule the pension reform legislation unconstitutional, which would jeopardize $32.7 billion of pension liability reduction."

In its 6-1 ruling, the court overturned a lower court ruling and found that Illinois' constitutional pension protections are not just limited to core pension earnings, but extend to other benefits provided under the retirement systems. The ruling wiped out changes Illinois made in 2012 that allowed the state to force retirees, including those who retired prior to enactment of the law, to pay higher health insurance premiums. The move provided annual savings of approximately $90 million, according to the state.

Here's why Moody's is concerned that the opinion places pension reform in jeopardy: The majority opinion states, "Where there is any question as to legislative intent and the clarity of the language of a pension statute, it must be liberally construed in favor of the rights of the pensioner." This and other sections of the ruling "signal how the court could side with pensioners when it eventually addresses the constitutionality of recent state pension reforms, which have already been challenged, as well as Chicago's pension reforms, which we expect will be challenged," Moody's said.

In December, Illinois passed reform that reduced cost-of-living adjustments (COLAs) for employees and retirees in four of the five state pension systems. (As a concession, the legislation also increased state contribution requirements and reduced employee contribution rates.) Moody's estimated that these and other changes reduced accrued liabilities of the three largest pension systems by approximately $32.7 billion combined, or 17 percent.

Liz Farmer
Governing.com

NASACT GASB Review: 2014

GASB Review: 2014
Register Now!

A NASACT Training Webinar
Wednesday, July 23, 2014
2:00 – 3:50 p.m. Eastern Time

Overview

NASACT, in conjunction with the Association of Government Accountants and the Association of Local Government Auditors, is pleased to announce the latest in its series of training events addressing timely issues in government auditing and financial management.

As fiscal year-end for most state governments quickly approaches and a new year begins, it's an opportune time for financial statement preparers and auditors to get a refresher on standards that will be effective for June 30, 2014, financial statements as well as recently released GASB statements that will require attention in fiscal year 2015.

This webinar will provide "must know" guidance on recently-issued GASB statements including GASB 71 – Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68. Also included will be coverage on previously-issued GASB statements that are effective for June 30, 2014 and 2015.

For 2014, these statements include:

Statement 65 – Items Previously Reported as Assets and Liabilities
Statement 66 – Technical Corrections – 2012, an amendment of GASB Statements No. 10 and No. 62
Statement 67 – Financial Reporting for Pension Plans
Statement 70 – Accounting and Financial Reporting for Nonexchange Financial Guarantees

Statements effective for 2015 are:

Statement 68 – Accounting and Financial Reporting for Pensions
Statement 69 – Government Combinations and Disposals of Government Operations
Statement 71 – Pension Transition for Contributions Made Subsequent to the Measurement Date

Join GASB chairman David A. Vaudt, GASB director of research David R. Bean, and other GASB staff for this informative two-hour training session. You will also be given an opportunity to ask questions and share experiences during the last 25 minutes of the audio conference.

CPE: Two credits

Cost: $299.00 per group (unlimited attendance); $50 per person;

Agenda:

2:00 – 2:05 p.m.
Welcoming Remarks
Kinney Poynter, Executive Director, NASACT

2:05 – 3:20 p.m.
GASB Review: 2014
David A. Vaudt, Chairman, GASB
David R. Bean, Director of Research, GASB
Other GASB Staff

3:20 – 3:45 p.m.
Live Q&A
Kinney Poynter, Executive Director, NASACT

3:45 – 3:50 p.m.
Wrap-up

Kinney Poynter, Executive Director, NASACT

Instructions and Materials: An email will be sent Monday, July 21, by 4:30 p.m. Eastern to all who have registered for this conference with the instructions on how to join the webinar and a link to the materials. Please note the instructional email will be sent only to the email address attached to the registration.

Learning Objectives: At the conclusion of this webinar, participants will be able to:

- Identify the major revisions of recently issued GASB pronouncements as well as those effective in FY 2014 and FY 2015
- Understand how the new requirements differ from the previous standards
- Apply the new principles in preparation and audits of FY 2014 financial statements

Delivery Method: Group-Live (for group settings) or Group-Internet Based (for individuals)

Level of Knowledge: Overview

Field of Study: Accounting (Governmental)

Advanced Preparation: All government officials and employees are encouraged to attend. No prerequisites are required. No advance preparation is necessary.

The National Association of State Auditors, Comptrollers and Treasurers is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be addressed to the National Registry of CPE Sponsors, 150 Fourth Avenue North, Suite 700, Nashville, TN, 37219-2417 or by visiting the website www.nasba.org.

Municipal Credit Default Swap Activity Jumps, But Overall Market Is Still Thin.

Summary

- In recent weeks the notional principal traded on U.S. states (9) and cities (1) has jumped up from very low levels.
- Only 11 sub-sovereign or municipal issues have traded since the DTCC began reporting weekly trade activity in July 2010.
- Trading is still very thin, but the rise in activity recently is something all investors in municipal bonds should monitor closely.

The bankruptcy of Detroit brings new pressure on municipal bond investors and related exchange-traded funds like HYD, NUV, PML, PZA, IIM, NIO and VMO specializing in municipal bonds to heighten risk management and to hedge where appropriate. One potential tool in that regard is the single name credit default swap market, which is featured almost constantly in discussions of municipal entity credit risk. A recent example is “Traders Find Short Bets on Puerto Rico a Challenge,” a Wall Street Journal blog. The author notes:

“Default insurance on Puerto Rico, sold in the form of derivatives called credit-default swaps, is available from few dealer banks. The contracts also have barely traded because the protection is not available to buy in meaningful amounts and disclosures from the Commonwealth have been limited, some market participants said."

The purpose of this note is to bring clarity and precision to discussions of municipal credit default swaps by providing facts from the Depository Trust & Clearing Corporation trade warehouse. It is simply not the case that Puerto Rico credit default swaps have "barely traded." The DTCC data makes clear that Puerto Rico credit default swaps have never traded in any week since the DTCC began reporting weekly on trading volume beginning with the week ended July 16, 2010. In fact, only 11 municipal or sub-sovereign names have ever been reported as trades to the DTCC trade warehouse during the 2010-2014 period. This note explains the details.

Continue Reading.

Donald van Deventer, Kamakura Corporation
Jul. 10, 2014 4:01 PM ET

P3S Could Speed Construction of Port and Inland Waterway Infrastructure, Army Corps Testifies.

The Army Corps of Engineers and lawmakers have high hopes that a newly created public-private partnership pilot program could help dent the backlog of critical infrastructure projects at the nation's ports and inland waterways, an agency official told the House Transportation and Infrastructure Committee's P3 Panel July 10.

The P3 pilot program, established in the recently enacted Water Resources Reform and Development Act, is designed to push the corps to seek private investment to speed work on port and inland navigation projects.

Using public-private partnerships will be a new way for the Corps of Engineers to finance the completion of infrastructure projects, said Jim Hannon, chief of the agency's operations and regulatory division. "We think there are some benefits that provide better value for money to the taxpayer by investigating opportunities to use these [P3] financing tools."

Applying P3s to water projects may prove to be more complex than initially imagined. Hannon noted that the corps does not have the authority to charge tolls or user fees for many of its projects and would need to find ways to spread the costs to other stakeholders beyond ports, shippers and private sector partners.

"How do we account for the federal investment share of the project in the budgeting process?" said Hannon. "Does it get counted upfront or is it accounted for over the entire length of the agreement."

The corps currently faces a massive backlog of more than 1,000 projects and studies on with an estimated price tag of $60 billion to $80 billion, according to the Heritage Foundation. Of the 257 locks in operation in 2009, 10 percent were built in the 1800s and the average age of federally owned locks was 60 years old.

"We approach the P3 opportunity as another way to get toward those other lock and dams improvements that are going to wait 20 to 30 years under the current program to get going," Mike Toohey, president and CEO of the Waterways Council, told the panel.

The panel also heard from John Crowley, executive director of the National Association of Waterfront Employers, and Dave Kronsteiner, president of the board of commissioners at the Port of Coos Bay, Ore.

By Editor July 11, 2014

S&P: U.S. State And Local Government Credit Conditions Forecast: Ramping Up After A Slower-Than-Expected Start.

With 2014 now halfway over, credit conditions for U.S. state and local governments continue to stabilize and are strengthening modestly. This is despite a sharp downward revision to the estimate of first-quarter GDP growth by the U.S. Bureau of Economic Analysis (BEA) and some emerging softness in state tax revenue collections in April. In Standard & Poor's Ratings Services view, it's useful to recall that measures of GDP, while important, are coincident indicators with data releases that lag the time period they measure. And our economists don't see the BEA's revision as signaling the start of a contractionary cycle. On the contrary, our forecast looks for a rebound in real GDP growth to 3.9% in the second quarter (annualized) followed by respectable rates of 3.3% in the third and fourth quarters.

After peaking in the third quarter of 2008, household debt declined for 17 of the subsequent 19 quarters. In our view, this deleveraging process was integral to the economy's slow recovery from the Great Recession. Now, however, households have increased their debt loads for three consecutive quarters, suggesting the economy has turned an important corner. Nevertheless, weak first-quarter growth will likely take a bite out of our forecast for overall real GDP growth in 2014, which was already at 2.3%, down from the 2.75% we anticipated just three months ago.

Read the full report.

CDFI Fund Invites Comment on Annual CDFI Reporting Form.

The U.S. Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund) is requesting public comment on a new reporting form for all certified Community Development Financial Institutions (CDFIs). The CDFI Fund is releasing this request for comment today in anticipation of its publication tomorrow in the Federal Register.

The objective of the Annual Certification and Data Collection Report Form is to enable the CDFI Fund to recertify CDFIs while reducing the burden of the process that currently occurs every three years. In addition to recertifying CDFIs, this report also seeks to collect financial and impact data on all certified CDFIs annually to provide the CDFI Fund and the community development finance industry with more insight into the state and accomplishments of CDFIs.

A certified CDFI is a specialized financial institution that works in markets that are underserved by traditional financial institutions. CDFIs provide a unique range of financial products and services in economically distressed target markets, such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers, flexible underwriting and risk capital for needed community facilities, and technical assistance, commercial loans and investments to small start-up or expanding businesses in low-income areas.

CDFI certification is a designation conferred by the CDFI Fund and is a requirement for accessing many of the CDFI Fund's award programs. The CDFI Annual Certification and Data Collection Report Form will replace the extensive process conducted every three years with a shorter annual report. This report will also collect financial and impact data from all CDFIs regardless of whether they have received monetary awards in their last fiscal year. This report will collect standardized data on the full universe of certified CDFIs.

Comments are specifically invited on:

- Whether the collection of information is consistent with the stated background and proposed use necessary for the proper performance of the functions of the CDFI Fund;
- The accuracy of the CDFI Fund's estimate of the burden of the collection of information;
- Ways to enhance the quality, utility, and clarity of the information to be collected;
- Ways to minimize the burden of the collection of information on respondents, including through the use of technology; and
- Estimates of operational or maintenance costs to provide information.
- The proposed Annual Certification and Data Collection Report Form and related Glossary are available on the CDFI Fund's website at www.cdfifund.gov/cdficert, in the Supplemental Resources section.

Written comments should be received on or before September 8, 2014 to be assured of consideration. All comments should be directed to Brette Fishman, Management Analyst at the Community Development Financial Institutions Fund, U.S. Department of the Treasury, 1500 Pennsylvania Avenue, NW, Washington, D.C. 20020; by e-mail to annualreport@cdfi.treas.gov; or by facsimile to (202) 508-0083. Please note that this is not a toll-free number.

July 8, 2014

U.S. Plans Up to $4 Billion in New Cleantech Loan Guarantees.

The U.S. Department of Energy (DOE) has issued a loan guarantee solicitation, making as much as $4 billion in loan guarantees available for innovative renewable energy and energy efficiency projects located in the U.S. that avoid, reduce or sequester greenhouse gases.

According to the DOE, this solicitation is intended to support technologies that are catalytic, replicable and market-ready. Although any project that meets the appropriate requirements is eligible to apply, the department has identified five key technology areas of interest: advanced grid integration and storage; drop-in biofuels; waste-to-energy; enhancement of existing facilities including micro-hydro or hydro updates to existing non-powered dams; and efficiency improvements.

"As [President Barack Obama] emphasized in his Climate Action Plan, it is critical that we take an all-of-the above approach to energy in order to cut carbon pollution, help address the effects of climate change and protect our children's future," says Energy Secretary Ernest Moniz.

"Investments in clean, low-carbon energy also provide an economic opportunity. Through previous loan guarantees and other investments, the department is already helping launch or jumpstart entire industries in the U.S., from utility-scale wind and solar to nuclear and lower-carbon fossil energy. Today's announcement will help build on and accelerate that success."

Currently, the DOE says its Loan Programs Office (LPO) supports a diverse portfolio of more than

$30 billion in loans, loan guarantees and commitments – supporting more than 30 projects nationwide. The projects that the LPO has supported include one of the world's largest wind farms; several of the world's largest solar generation and thermal energy storage systems; and more than a dozen new or retooled auto manufacturing plants across the country, the department adds.

[Jones Day: FERC Acts to Ensure that Utility Cost-Based Rates Include an Adequate Return on Equity.]

In June, the Federal Energy Regulatory Commission ("FERC" or "Commission") issued Opinion No. 531, which details three significant changes to the way FERC determines the rate of return on equity ("ROE") in public utility rate cases.1 First, FERC modified its longstanding discounted cash flow ("DCF") model for calculating ROE.2 Second, FERC ended its practice of applying a post-hearing adjustment to ROE based on changes in United States Treasury bond yields.3 Third, FERC decided that the ROE of the group of public utilities in question should not be set at the "point of central tendency" established by the range of reasonable ROEs, but instead should be set at the point halfway between the range's point of central tendency and the range's highest point.4 Each of these changes is explained below.

In conjunction with Opinion No. 531, FERC set for hearing a backlog of cases involving disputes over public utility rates.5 In each case, the Commission stated that "we expect the evidence and any DCF analyses presented by the participants in this proceeding to be guided by our decision in Opinion No. 531."6 As compared to FERC's preexisting approach to ROE, Opinion No. 531 appears likely to increase the ROE component in public utility cost-based rates, thereby increasing a public utility's overall return. However, the long-term reach of FERC's new ROE analysis remains unclear.

How Regulators Use the DCF Model and Establish a Range of Reasonable ROEs

Under cost-of-service ratemaking, certain costs are considered operating expenses and are recovered dollar-for-dollar in the utility's annual revenue requirements, while other costs are capitalized, "thus entering the cost of service in the form of annual allowances for depreciation and return on the undepreciated portion of the investment."7 In order to attract necessary capital, the utility must offer "a risk-adjusted expected rate of return sufficient to attract investors."8 This "return" on the utility's investments represents the cost expended by the utility to raise capital.9

For more than 30 years, the dominant method used by FERC to estimate investors' required rate of return has been the DCF model. The premise of the DCF methodology is that "an investment in common stock is worth the present value of the infinite stream of dividends discounted at a market rate commensurate with the investment's risk."10 This "constant growth" DCF model can be expressed as a formula:

$k = D/P\ (1+0.5g) + g.$

In this formula, D is the current dividend, P is the price of the company's common stock, and g is the expected growth rate in the company's dividends. The formula solves for k, which represents the rate of return investors require to invest in a company's common stock.11

In a rate case, FERC applies the DCF formula to each member of a group of comparable utilities, known as a proxy group. This generates a range of ROEs. Screening criteria, which can result in the exclusion of particular companies from the analysis, are applied to establish a range of reasonable

ROEs. The ROE of the public utility that is the subject of FERC's review is selected from within this range. FERC's past practice has been to set the subject public utility's ROE at the point of central tendency of the proxy group's range of ROEs.

Applying the Two-Step DCF Methodology to Public Utilities

Since the mid-1990s, FERC has used a "one-step" DCF methodology in public utility rate cases (i.e., in the electric industry) while using a "two-step" DCF methodology in natural gas pipeline and oil pipeline rate cases. Under the one-step DCF methodology, FERC calculates two dividend yields for each proxy group company: one based on the proxy group company's highest stock price from a six-month study period, and one based on the proxy group company's lowest stock price from the same study period. Next, FERC develops two estimates of short-term dividend growth rates. A low cost of equity for each proxy group company is developed using the lowest dividend yield plus the lowest dividend growth rate projection. A high cost of equity for each proxy group company is developed using the highest dividend yield plus the highest dividend growth rate projection.12

In Opinion No. 531, FERC decided that henceforth it will apply the two-step DCF methodology in public utility rate cases. The result is a single average dividend yield calculated for each company in the proxy group. The dividend growth rate estimate for each proxy group company will take into account both projected short-term growth rates (constituting two-thirds of the total growth rate estimate) and projected long-term growth (one-third of the total).13 The short-term growth rate estimate will be based on the five-year forecast for each proxy group company, as published in the Institutional Brokers Estimate System ("IBES"). The long-term growth rate estimate will be based on forecasts of the long-term growth of the economy as a whole, stated in terms of gross domestic product.14 In the case before it, FERC reopened the record and established a "paper hearing" to give the participants in that case "an opportunity to present evidence concerning the appropriate long-term growth projection to be used for public utilities under the two-step DCF methodology."15

Eliminating the Post-Hearing ROE Adjustment Based on U.S. Treasury Bond Yields

FERC's cost-of-service ratemaking for public utilities relies predominantly on "test-period" evidence, which is evidence about the subject utility's costs limited to a specific time period that ends before the rate case goes to hearing. Use of test-period evidence gives the parties a known universe of facts to dispute. One exception is FERC's use of post-test-period data regarding ROE. FERC's practice has been to adjust the subject utility's ROE based on U.S. Treasury bond yields. FERC determines the change in U.S. Treasury bond yields as of the date of its order as compared to such yields as of the end of the hearing in the case.16 FERC then adjusts the final ROE by the amount of the change in U.S. Treasury bond yields. For example, a 1 percent drop in bond yields between the end of a hearing and FERC's order would result in a 1 percent downward adjustment to the utility's ROE.17

In Opinion No. 531, FERC decided that U.S. Treasury bond yields no longer "provide a reliable and consistent metric for tracking changes in ROE after the close of the record in a case."18 Instead, FERC will allow participants in a rate case "to present the most recent financial data available at the time of the hearing, including post-test period financial data then available."19 FERC already uses this approach in natural gas pipeline and oil pipeline rate cases.20

Selecting an ROE From Within the Range of Reasonable ROEs

Once a range of reasonable ROEs is developed by applying the DCF model to each member of a proxy group, FERC must select one ROE from within that range. Traditionally, FERC has set the subject public utility's ROE at the "point of central tendency" within the range of ROEs. For a diverse group of public utilities, the point of central tendency is the midpoint within the range, which, as FERC uses the term, is the arithmetic mean of the single lowest and the single highest ROE. In contrast, for an individual public utility, the point of central tendency is the median.21 The median is the middle number in a series, such that half of the numbers are higher and half are lower than the median.

In Opinion No. 531, the issue in dispute was the appropriate ROE for the New England Transmission Owners, a group of utilities that had transferred operational control of their transmission facilities to ISO-New England. FERC decided that it would not set the ROE at the midpoint of the range of ROEs. Instead, FERC selected the point halfway between the midpoint and the highest point in the zone of reasonableness (the 75th percentile), which FERC described as the "central tendency for the top half of the zone of reasonableness."22 In Opinion No. 531, the resulting midpoint was 9.39 percent, but the point at the 75th percentile of the range was 10.57 percent.

In rejecting the midpoint ROE, FERC explained its concern that the "capital market conditions in the record are anomalous, thereby making it more difficult to determine the return necessary to attract capital."23 The New England Transmission Owners had argued that five other "benchmark methodologies" showed that the DCF-based midpoint in that case was too low to attract capital: (i) a risk premium analysis, which examines the premium that investors require to invest in equities; (ii) a capital asset pricing model ("CAPM"), which is a model that examines investor expectations about the future by taking into consideration the tendency of a stock's price to follow changes in the market as a whole; (iii) an analysis of natural gas pipeline ROEs; (iv) a DCF analysis applied to non-utilities; and (v) an expected earnings analysis, which involves a comparison of the earnings investors can expect to receive from investing in public utilities, as compared to investing in other opportunities of comparable risk.24

FERC found that the risk premium analysis, the CAPM, and the expected earnings analysis were "informative" and supported the conclusion that the midpoint ROE was too low to attract capital. FERC did not consider the DCF analysis of non-utilities or the natural gas pipeline ROE analysis to be probative because they did not analyze the returns of public utilities.25

At several points, FERC's analysis focused on the unique characteristics of companies in the business of building and owning electric transmission assets. For example, FERC found persuasive the fact that state regulatory commissions have approved public utility ROEs above the DCF midpoint ROE. According to FERC, transmission investment "entails unique risks that state-regulated electric distribution does not."26 Investors in electric transmission infrastructure face risks such as "long delays in transmission siting, greater project complexity, environmental impact proceedings, requiring regulatory approval from multiple jurisdictions overseeing permits and rights of way, liquidity risk from financing projects that are large relative to the size of a balance sheet, and shorter investment history."27 FERC emphasized that it has an obligation to set an ROE in this case "at a level sufficient to attract investment in interstate electric transmission," explaining that such investment "helps promote efficient and competitive electricity markets, reduce costly congestion, enhance reliability, and allow access to new energy resources, including renewables."28

Opinion No. 531 may allow a utility to justify an ROE greater than the median without making a company-specific showing of relative risk. In prior decisions, FERC has required a showing that the risk affecting the subject company be higher than the risk faced by the other members of the proxy group. As recently as 2013, FERC explained that any analysis attempting to "demonstrate that a deviation from the median ROE is justified" must present a comparison between "the risk level of the subject company and the risk level of each of the proxy group companies. This is the crux of the analysis, and if it is lacking, the analysis is incomplete."29 In light of the general evidence relied on in Opinion No. 531, a company-specific showing of relative risk may no longer be the "crux" of the analysis.

Finally, FERC explained that its decision to set the New England Transmission Owners' base ROE above the range's point of central tendency involved considerations that are distinct from its analysis of "incentive adders" pursuant to Section 219 of the Federal Power Act.30 FERC's task when evaluating a base ROE is to set the ROE at a level that "enables the utility to attract investment." In contrast, FPA Section 219 authorized FERC to establish incentive above that base ROE. FERC cautioned that it will not permit its new analysis of base ROE and its analysis of FPA Section 219 incentives to be combined in a way that results in an ROE that exceeds the top of the zone of reasonableness established by its new two-step DCF methodology.31

Likely Effect on Public Utility Rates

FERC's departure in Opinion No. 531 from three aspects of its existing policy on ROE will result in a higher ROE for the New England Transmission Owners. In the Initial Decision under review in Opinion No. 531, the Administrative Law Judge found that the prospective ROE for the New England Transmission Owners should be set at 9.7 percent.32 In contrast, FERC's analysis in Opinion No. 531 resulted in a tentative finding that the appropriate ROE was 10.57 percent.33

Opinion No. 531's higher ROE did not result from FERC's switch to the two-step DCF model. The two-step DCF model alone resulted in a midpoint ROE of 9.39 percent34—lower than the prospective 9.7 percent ROE approved in the Initial Decision. Rather, the higher ROE resulted from FERC's decision to select the midpoint of the "upper half" of the zone of reasonableness rather than selecting the midpoint of the full zone. Moreover, FERC's focus on the midpoint as the point of central tendency (because the ROE of a group of utilities was at issue) raises questions about how FERC's analysis from Opinion No. 531 will be applied in the context of setting a single public utility's ROE, where the Commission uses the median of the range of reasonable ROEs as opposed to the midpoint.35 Notwithstanding the differences in the ROE analysis for a single utility and grous of utilities, the Commission's order in Seminole Electric Cooperative, Inc. v. Florida Power Corp. instructs the parties to apply Opinion No. 531 in establishing a single utility's ROE.36

FERC also emphasized that the new two-step DCF model produces "a narrower zone of reasonableness, consistent with the fact [that] different firms in a regulated industry would not ordinarily be expected to have widely varying levels of profitability."37 This narrower zone of reasonableness may result in a point of central tendency within the "upper half" of the zone of reasonableness that is close enough to the overall point of central tendency to support the selection of that higher ROE.

In sum, although two aspects of Opinion No. 531 will apply in all future public utility rate cases, the largest identifiable change in the ROE in that order was based on a case-specific analysis—performed in the context of "anomalous" capital market conditions—of the level of return needed to encourage investments in transmission where that ROE will apply to a group of public utilities rather than to a single public utility. Had FERC's ROE policies remained unchanged, the result would have been lower ROEs. Therefore, Opinion No. 531 is likely to increase public utility returns in cost-based rates, but the scope and magnitude of this effect as applied to other public utilities remains unclear.

Footnotes

1 Martha Coakley v. Bangor Hydro-Electric Co., Opinion No. 531, 147 FERC ¶ 61,234 at P 7 (2014) ("Opinion No. 531"). A public utility is an entity subject to the Federal Power Act because it owns facilities used for the transmission of electric energy in interstate commerce or for the sale of such energy at wholesale in interstate commerce. 16 U.S.C. § 824 (2012).

2 Opinion No. 531 at PP 32–41.

3 Id. at PP 157–160.

4 Id. at P 151.

5 ENE (Environment Northeast) v. Bangor Hydro-Electric Co., 147 FERC ¶ 61,235 (2014); Seminole Electric Cooperative, Inc. v. Florida Power Corp., 147 FERC ¶ 61,236 (2014); Seminole Electric Corp. v. Duke Energy Florida, Inc., 147 FERC ¶ 61,237 (2014); Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Co., 147 FERC ¶ 61,238 (2014); Golden Spread Electric Cooperative, Inc. v. Southwestern Public Service Co., 147 FERC ¶ 61,239 (2014).

6 Seminole Electric Corp. v. Duke Energy Florida, Inc., 147 FERC ¶ 61,237 at P 21.

7 Alfred E. Kahn, The Economics of Regulation: Principles and Institutions 27 (2nd ed. 1988).

8 Canadian Ass'n of Petroleum Producers v. FERC, 254 F.3d 289, 293 (D.C. Cir. 2001).

9 See id.

10 Opinion No. 531 at P 14 (citing, as an example, Canadian Ass'n of Petroleum Producers, 254 F.3d at 293).

11 Id. at P 15.

12 Id. at PP 25–26.

13 Id. at P 39.

14 Id. at P 39.

15 Id. at P 43.

16 Id. at P 157.

17 Id. at P 159.

18 Id. at P 160.

19 Id. at P 160.

20 Id. at P 160.

21 Id. at P 26.

22 Id. at P 151.

23 Id. at P 145.

24 Id. at P 146.

25 Id. at P 146.

26 Id. at P 148.

27 Id. at P 149.

28 Id. at P 150.

29 El Paso Natural Gas Co., 145 FERC ¶ 61,040 at P 698 (2013); see also id. at P 686 (reversing the Administrative Law Judge's finding that the pipeline's relative risk justifies an ROE "well above" the median of the proxy group companies, and setting the pipeline's ROE at the median). See, e.g., Southern California Edison Co., 92 FERC ¶ 61,070 at 61,266 (finding that the appropriate ROE for the subject public utility should be above the point of central tendency for the comparison group because the utility "is more risky than the comparison group"), reh'g denied, 108 FERC ¶ 61,085 (2004).

30 Opinion No. 531 at P 153.

31 Id. at P 165.

32 Id. at P 5.

33 Id. at P 142.

34 Id. at P 147.

35 See S. Cal. Edison Co. v. FERC, 717 F.3d 177, 186 (D.C. Cir. 2013).

36 Seminole Electric Cooperative, Inc. v. Florida Power Corp., 147 FERC ¶ 61,236 at P 16.

37 Opinion No. 531 at PP 38, 161.

Last Updated: July 2 2014

Article by Kenneth B. Driver, James C. Beh, Kevin J. McIntyre, Matthew R. McGuire and William Weaver

---

How S&P Intends to Implement its Revised Rating Methodology and Assumptions for Affordable Multifamily Housing Bonds and Apply them to Ratings.

On June 19, 2014, Standard & Poor's Ratings Services published its revised criteria, "Rating Methodology and Assumptions for Affordable Multifamily Housing Bonds". Included in the scope of the criteria are affordable multifamily housing bonds supported by unenhanced affordable housing projects (AHP), federally subsidized housing projects (e.g., Section 8), privatized military housing projects, and multifamily loan pools rated in the U.S. These criteria exclude and do not apply to bonds secured by FHA-insured mortgage loans; Ginnie Mae, Fannie Mae, or Freddie Mac mortgage-backed securities; or other federal credit enhancement programs.

The new criteria became effective upon publication. The criteria apply to all new and existing in-scope transactions. We plan to complete our review of all existing ratings within six months. We will accept requests for expedited review of ratings during this process. Though highly unlikely, we could lengthen this schedule if a material credit event occurs, particularly if the impact could take some time to assess. However, we would clearly communicate any change in our plans.

The criteria update is part of Standard & Poor's commitment to the market to enhance the transparency, rigor, and specificity of its criteria across sectors and asset classes. Our objective is to provide market constituents with greater insight into how we rate affordable multifamily housing bond transactions and to enhance the global comparability of our ratings through a clear, coherent, and globally consistent criteria framework.

We began communicating the process of updating our criteria when we published an advance notice of proposed criteria change in March 2013. We then published our proposed revised ratings framework, "Request for Comment: Rating Methodology and Assumptions for Affordable Multifamily Housing Bonds" on April 1, 2013. During the subsequent two-month comment period, we interacted with market participants within the U.S., released a CreditMatters TV segment, and conducted a teleconference in order to outline the framework and respond to questions on the proposed criteria change. We used these outlets to increase participants' awareness and understanding of the proposed changes and to solicit, evaluate, and incorporate feedback where appropriate. In conjunction with the release of the new criteria, we responded to market participants with an article outlining the feedback we received and what changes were incorporated into the final criteria in the publication "RFC Process Summary: Rating Methodology And Assumptions For Affordable Multifamily Housing Bonds", published June 19, 2014.

We are now providing information about the likely ratings impact of the criteria changes, a more detailed explanation of the implementation process, and comments on how we intend to apply the revised criteria to our current ratings.

How We Expect The New Criteria To Affect Ratings

The criteria affect approximately 350 rated issues, comprising about 150 discrete projects and programs. Based on our preliminary analysis, the expected impact on outstanding issue ratings is as follows:

- No impact on approximately 80% of the issue ratings, while 10% may be upgraded and 10% may be downgraded.
- The expected rating change for the affected issue ratings is one notch in most cases and two notches in some cases.

How We Will Implement The New Criteria

We intend to review all of the in-scope transactions within six months of the effective date of the new criteria. Our implementation schedule is as follows:

June 19, 2014
Standard & Poor's Released the Rating Methodology and Assumptions for Affordable Multifamily Housing Bonds

Week of June 23—June 27, 2014
We applied these criteria to all new issues in scope of these criteria regardless of the original request date of the rating.
Any rating reviews, whether scheduled or event-driven, were assessed under the new criteria.

Week Of June 30-July 3, 2014

Ratings that may be impacted based on our quantitative testing will be placed on CreditWatch with positive or negative implications, as applicable, or under criteria observation based on the revised methodology.
Ratings that are scheduled for their regular reviews will also be placed on CreditWatch with developing implications, pending the receipt of additional information needed to complete the reviews under the new criteria.

Week Of July 7-July 11, 2014
We plan to send out questionnaires to issuers/obligors requesting the information we need to review all existing in-scope transactions under the new criteria.
We will upload the criteria and related articles, as well as explanatory materials, including CreditMatters TV videos, onto our dedicated public website www.sandp.com/hess to allow for easy access and maximum transparency.
We will conduct a WebEx seminar to outline the criteria framework and answer questions from issuers and obligors.
We cannot disclose the timing of any reviews for particular credits beyond the guidance provided in this notice.

Week Of Aug. 6-Aug. 11, 2014
We plan to send out a second request for information 30 days after the initial request if no response is received, or if the information we receive is insufficient to complete our review under the new criteria.

Week Of Sept. 5-Sept. 10, 2014
We intend to maintain the ratings on all debt rated under the previous criteria. However, for issuers and obligors who have not responded with complete information for in-scope transactions within 30 days after our second request for information, those issues will be placed on CreditWatch with negative implications in accordance with our credit rating suspension/withdrawal policy.

July 7-Oct. 10, 2014
Once we complete our reviews of ratings that have been placed on CreditWatch as described above, we will then review the remaining in-scope ratings.
We will accept requests for expedited review of ratings during the implementation period.

How We Will Communicate Our Rating Actions
We will publish rating reports on all transactions reviewed under the revised criteria.

Format Of Our Rating Reports
Each rating report will include our assessment of the following components:

- Drivers of housing demand;
- Strength of local housing market;
- Level of on-going government support;
- Strategy and management;
- Construction risk (if applicable);
- Loss coverage;
- Financial strength;
- Asset quality;
- Military housing asset quality (if applicable);
- Operating performance; and
- Financial policies and practices.

Upon release, ratings and rating reports will be available on RatingsDirect. Ratings and criteria are available on www.standardandpoors.com.

Related Criteria And Research

Rating Methodology And Assumptions For Affordable Multifamily Housing Bonds, June 19, 2014
RFC Process Summary: Rating Methodology And Assumptions For Affordable Multifamily Housing Bonds, June 19, 2014
Rating Methodology And Assumptions Ffor U.S. and Canadian CMBS, Sept. 5, 2012
CMBS Global Property Evaluation Methodology, Sept. 5, 2012
Application Of CMBS Global Property Evaluation Methodology In U.S. And Canadian Transactions, Sept. 5, 2012

Primary Credit Analysts:

Mikiyon W Alexander, New York (1) 212-438-2083;
mikiyon.alexander@standardandpoors.com

Karen M Fitzgerald, CFA, New York (1) 212-438-4858;
karen.fitzgerald@standardandpoors.com

Valerie D White, New York (1) 212-438-2078;
valerie.white@standardandpoors.com

01-Jul-2014

Growth In Green Bond Market Underscores Need For Market Standards.

The significant growth that we have seen in the past year in green/climate bond issuances – $11.4 billion in 2013 and an estimated $40 billion in 2014 – strongly suggests a threshold market acknowledgement of the enormous potential in these instruments. Growth in the market and a rapid increase in the volume of climate/green bonds strongly suggest that we are approaching a broad yet fundamental market acceptance of this new asset class. If so, it is important that we begin to shift gears and move from proving the model to creating the market infrastructure that incorporates meaningful standards to support a wider and more liquid market for climate/green bonds.

Green bonds and climate bonds are issued to pay for environmental projects. These are often issued by large institutions, such as World Bank, Bank of America, and Toyota that invest in both environmental and non-environmental projects. However, the proceeds from these bonds are invested exclusively in environmental projects. Many, but not all green bonds are climate-focused. Climate bonds, however, are totally linked to assets that encourage a rapid transition to a low-carbon and climate resilient economy.

These bonds can be considered the equivalent of infrastructure bonds tailored specifically to finance climate solutions, thus providing institutional investors with the opportunity to direct their capital into investments that more appropriately meet their financial and social preferences.

When tied to specific climate change mitigation investments, these finance instruments allow markets to raise capital or, more specifically, support the private sector in raising capital to:

- build renewable energy generation and its enabling infrastructure,
- widely implement energy efficiency measures in cities and industries, and
- support adaptation measures that will boost the economic development of communities in the face of climate change.

Green bonds are not so different after all

Bonds are financial products best suited to both the financing of energy projects with long payback periods and to providing institutional investors with security of returns over the longer term. They are used to unlock "patient capital," specifically taking savings which require secure returns over long periods of time (such as those held by pension funds) and investing them in low-carbon projects that have high up-front costs but solid payback rates over the longer term. Developing a market specifically for climate-themed bonds will help grow markets more broadly for associated "green" debt capital.

These bonds need not differ significantly from existing issuances of debt. The only difference is that the funds they attract are supported by real and verifiable energy projects that in some certifiable manner serve to mitigate greenhouse gas emissions. They also allow investors to report to their members on how their secure investments are making a contribution to addressing climate change.

However, to foster liquidity in a themed bond space, an agreed set of rules and criteria is absolutely essential to assure investors of the integrity of each environmental themed bond. A system of standards for the labeling of green debt holds the promise of being a key enabler for pension fund investment and freeing up significant amounts of private capital in support of climate change mitigation.

To flourish, green bonds need standards

In a direct effort to encourage transparency, disclosure, and integrity in this environmental bond market, a consortium of nearly fifty financial institutions are backing a set of voluntary "Green Bond Principles" (GBPs). These GBPs were initially drafted by four of the financial institutions – Bank of America Merrill Lynch, Citi, Crédit Agricole Corporate, and JP Morgan Chase – with guidance from issuers, investors, and environmental groups. They are designed to serve as voluntary guidelines on recommended processes for the development and issuance of green bonds.

These critical standards are intended to help issuers, investors, and underwriters by:

- providing guidance on the key components involved in launching credible green bonds,
- ensuring investors have adequate information to assess the environmental impact of their investments, and
- moving the market towards standard disclosures which will facilitate transactions.

These voluntary guidelines are fundamentally designed to encourage transparency and integrity in the market and to prevent "greenwashing" – the practice of deceptively promoting something as green or good for the environment. This is particularly important as the issuer base shifts from trustworthy, multinational development banks to corporate issuers. To the extent that the GBP can achieve the objectives outlined above, these instruments will ultimately truly matter when they can consistently attract a new and broader investor base, thus becoming vehicles for channeling lower cost capital into energy efficiency, renewable energy, and climate change adaptation efforts.

The Green Bond Principles can further serve to catalyze this market, transforming green/climate bonds into a "mainstream" asset class by creating more certainty around investment integrity. U.S.

sub-national issuers of capital can and should play a critical role in helping to foster and develop this new asset class as well as the market infrastructure in which these instruments may flourish. The bottom line is that these new investment vehicles need to be treated like, and designed like, more traditional financial products, and the Green Bond Principles are a very good start to growing this important climate market instrument.

By Vic A. Rojas
Vic A. Rojas is Senior Manager, Financial Policy, for Environmental Defense Fund.

Army Chief of Engineers Looks to P3S for Nation's Water Infrastructure Needs.

The Army Corps of Engineers (USACE) is looking at new ways to finance the essential civil works infrastructure on U.S. waterways, including public-private partnerships according to Lt. Gen. Thomas Bostick, the agency's commanding general.

"We can only do so much through process efficiencies. We're going to have to work together in public-private partnerships to find some alternative financing means that come from outside the federal government," Bostick told reporters last week.

Some Corps projects have an identifiable revenue stream. The Corps currently collects fees on shipping companies that use deep-sea ports and inland waterways. However, projects such as levees do not have an obvious revenue stream, according to Bostick.

"We have to find a way to monetize the things we want the private sector to invest in," Bostick said. "At the end of the day, they need to make a profit, and we have to find ways to set up long-term contracts that will allow them to accrue benefits based on the investments they make."

Bostick's comments come as the Corps faces a backlog of $60 billion in recapitalization projects, according to a 2013 review. That same year, the American Society of Civil Engineers issued a grade of a D- to the network of 15,000 miles of levees and infrastructure along the thousands of miles of inland waterways in the United States. Hydro-power dams earned a modestly higher grade of D.

"The infrastructure is slipping in its ability to deliver consistent and reliable services," Bostick told Federal News Radio. "Since 2000, we've had a 50 percent increase in the downtime of our hydroelectric equipment. Since 2009, delays and interruptions have more than doubled on our inland waterway locks and dams. And 16 percent of our dams are categorized as 'extremely' or 'very high' risk, which increases the urgency for dam safety work."

Congress funds the Corps' recapitalization projects at around $2 billion per year. But even as the Corps continues to focus on the nation's highest priorities, the projects it is working on this year will require an additional $23 billion to complete.

"That gives you some idea of how long our current projects will take at the pace we're getting appropriations," he said.

By Editor July 1, 2014

Municipal Market Advisors Municipal Issuer Brief - June 30, 2014

Municipal Market Advisors Municipal Issuer Brief – June 30, 2014

Senator Files PAB Proposal as Amendment to Transportation Bill.

The Senate's leading advocate for expanding private water-wastewater infrastructure financing has filed his plan as an amendment to a transportation bill expected to receive a vote in the Senate Finance Committee next month. It is not clear, however, whether the committee will accept the amendment.

Offered by Sen. Bob Menendez (D-N.J.), the amendment would eliminate state-based caps on the amount of private activity bonds (PABs) that can be used to finance water and wastewater infrastructure. The amendment is based on the "Sustainable Water Infrastructure Act" (S. 2345), a stand-alone bill Sen. Menendez introduced last month.

Current law allows private entities (with state government approval) to issue PABs to fund a variety of infrastructure projects that deliver a public benefit, but the total amount of PABs that may be issued annually in each state is limited. This means water projects must compete for limited PAB financing with a variety of other infrastructure sectors.

Sen. Menendez proposed the amendment in advance of the Finance Committee's consideration of a bill to shore up the federal highway trust fund. The committee plans to markup the highway legislation next month.

New Tennessee Law Insulates State Credit Rating from Cities' Financial Problems.

Credit markets view the move as a positive for the state but negative for municipalities.

As the debate about how much financial help states should offer their distressed cities takes place across the country, one state has made a move to avoid the question altogether.

In July, a new law goes into effect in Tennessee that forbids the state from spending its own resources to repay the debts of distressed municipal governments. The legislation does not alter Tennessee's emergency loan assistance program, which puts the onus on local governments to request assistance before any default. But the new law is a win-lose in that it's viewed by the credit markets as a positive for the state and a negative for its local governments.

As Tennessee has historically had a policy of not paying debt service for stressed municipalities, the action is more of a clarification, rather than a change in policy. Still, said Julius Vizner, assistant vice president at Moody's Investors Service, it's an important distinction.

Financially Distressed Cities Isolate Poor and Minorities, Former Receiver Says
"The state is drawing a line here between its fiscal responsibilities and realities," Vizner said. "In general, the fact that the state is not incurring a liability for any potential future case of a local

government [wanting direct aid], is a credit positive."

States vary in how involved they get with their distressed municipalities and there are arguments for and against doing so. A big reason to intervene is that state intervention can reduce any chilling effect – that one government's distressed finances could spread to neighboring localities. Michigan, for example, views state intervention as key to its survival and has had long history of state involvement in city finances. Typically, aid comes in the form of a state-appointed emergency financial manager for its cities. But in the case of Detroit's bankruptcy, this year the state went the beyond that. In June, Gov. Rick Snyder signed into law a funding package that allocated nearly $200 million in state funds for a so-called grand bargain to try to help the Motor City emerge from bankruptcy. The package also included $366 million pledged over 20 years by philanthropic foundations and would go toward pension payments for Detroit's retired city workers and keeping the Detroit Institute of Art's work from being sold to pay creditors.

There are, however, counterarguments for states getting very involved in their distressed municipalities and Tennessee's desire to keep its high credit rating protected isn't unfounded. (Tennessee is rated either AAA or one notch below, depending on the rating agency.) Recently, Standard and Poor's rating agency revised its outlook on Michigan's credit down to stable from positive. The state maintained its AA- rating but S&P noted that Michigan's budget reserve fund will decrease because of the transfer to Detroit. In their comments, the analysts said the "appropriation to the Detroit bankruptcy settlement also raises questions as to potential future state contributions to other distressed localities and school districts" and that S&P would continue to monitor the situation.

Unlike Michigan, Tennessee does not allow its municipalities to file for bankruptcy and none of its local governments are rated below investment grade. So, even if a government were to default on debt, it wouldn't necessarily present the same threat to the state economy the same way that similarly distressed municipalities in Michigan might. It would depend on the circumstances, said Vizner, but Tennessee's overall economy is healthy so a local government default would likely be viewed as an anomaly.

Pew Charitable Trusts, which has conducted extensive research on state interventions, said that not every state actually needs a program. It advises that states design programs to be proactive in detecting and tackling local government financial challenges. However, most programs are reactionary.

GOVERNING.COM
BY LIZ FARMER | JULY 1, 2014

The Risks States Take for Their Distressed Cities.

Wall Street can be hard on a state that moves to keep its local governments solvent or help them through bankruptcy. But it's a chance that some states have decided is worth taking.

Two years ago, Wells Fargo declared state and local governments' efforts to deal with critical fiscal issues to be "light years ahead" of the federal government's. It's hard to argue with that assessment. But beyond the Beltway, the interplay between states and local governments in the wake of the Great Recession has raised unprecedented challenges. It has displayed stark differences in the roles states choose to play in dealing with their distressed localities. And it has highlighted the question of how much credit risk those states are willing to take on to help get their local governments' houses in order.

In looking at the municipal bankruptcies (or near-bankruptcies) in Alabama, California, Michigan, Pennsylvania and Rhode Island, the roles of the respective states ranged from adverse (Alabama) to seemingly irrelevant (California) to positive (Maryland, Michigan, Pennsylvania and Rhode Island). The Great Recession demarcated states into those with oversight programs that either protected against municipal insolvency or offered good support for troubled communities; those that accepted risks and reacted by changing their laws; and those that appeared to contribute to the distress and avoid the acceptance of any risk. The hard issue for state leaders was — and is — a fear of credit-risk contagion.

State involvement in local fiscal distress carries risks both fiscal and political. Nowhere is that playing out more starkly than in Detroit's bankruptcy with the truly extraordinary and bipartisan involvement by Michigan Gov. Rick Snyder and the state's legislative leaders.

When Standard and Poor's recently revised its outlook on Michigan's credit downward from positive to stable, it cited several economic and fiscal factors, including softening revenue. But the rating agency noted another factor: Michigan's recent decision to dip into its rainy-day fund to contribute $195 million to Detroit's city-government retirees as a critical part of the so-called "grand bargain" for the Motor City's exit from bankruptcy. S&P wrote that the state's action "raises questions as to potential future state contributions to other distressed localities and school districts."

S&P's action wasn't a big surprise in Lansing. In a statement to the Bond Buyer, a spokesperson for the governor's office wrote: "We knew the Detroit settlement package and [budget stabilization fund] was a concern with the rating agencies, which is why the Governor felt it was important to address head on and show why the package was a financially responsible, smart way for the state to address Detroit," adding that the contribution was unlikely to set a precedent for other distressed local governments in the state. Subsequently, Fitch Ratings affirmed its AA rating and stable outlook on the state's general-obligation bonds, and Moody's affirmed its Aa2 rating with a positive outlook.

Needless to say, S&P did not analyze what its rating might have been had the governor and bipartisan state legislative leadership not stepped up to the plate; as far as Michigan's leaders were concerned, the far greater potential credit risk was not to act. Indeed, the question for states is how to balance the credit risk of non-involvement versus involvement. In some states — especially smaller ones such as Rhode Island or Maryland, where a default by Providence or Baltimore would have led to significant repercussions to the states' economies and credit ratings — whether the state needed to establish a proactive role could not really be in question. In a similar sense, state leaders in Albany and Lansing have clearly recognized the critical role of New York City and Detroit to their states' economies.

Cities' and counties' fiscal distress or bankruptcy cannot be isolated from their states' economies, as much as legislators in Springfield, Ill., or Montgomery, Ala. might wish they could. Thus, statutory "emergency rooms" of some sort — or "pre-emergency rooms," such as long-established programs in New Jersey and North Carolina that have worked to prevent any municipal bankruptcy filings — have demonstrated efficient means to provide state oversight without debt adjustment. Many states require municipalities to regularly submit audit reports and budgets to a state division of local government, and other oversight programs allow intervention when budgets are out of balance. Some states may also offer temporary assistance through loans or emergency grants.

The focus of such state oversight programs is to maintain or improve local governments' fiscal and managerial functionality. State policy-makers recognize that when that functionality disappears in the calamity of a bankruptcy, it will be the state's taxpayers and its credit rating that will be at risk.

Programs like these, of course, present their own risks to states, such as setting a precedent that would trigger comparable assistance to other distressed communities; forgoing investments in infrastructure or education in order to prop up a city or county's pensions; or creating an impression that a state will weigh in against its investors in favor of its poorly managed municipalities.

But in accepting risks like these, a state is betting that its constructive role will not just cure a cancer and prevent its spread, but, more importantly, lay the foundation for accruing economic benefits to the region and state that outweigh any capital-markets costs. And the state is aiming to lay the foundation for a more constructive state-local relationship for the future.

BY FRANK SHAFROTH | JUNE 30, 2014

Frank Shafroth is the director of the Center for State and Local Government Leadership at George Mason University.

Illinois Pension Reform in Question on Insurance Ruling.

Illinois can't cut contributions to government retirees' health-insurance premiums, the state's top court said in a ruling with possible implications for Governor Pat Quinn's bid to fix a $100 billion pension shortfall.

The Illinois Supreme Court, in a 6-1 decision today, ruled the health-insurance premium subsidies are pension benefits protected by the state's constitution that can't be diminished or impaired, as Illinois lawmakers tried to do with a 2012 law that let an administrator determine the level of contributions.

Protection of pension benefits is the same provision in the Illinois constitution retirees are relying on in challenging Quinn's plan to cut the pension shortfall with reductions in cost-of-living adjustments and increasing the retirement age for workers who are now 45 or younger.

Illinois has the largest pension-funding shortfall of any U.S. state. The remedial legislation has been delayed by court order until the case is decided.

The threat to Illinois' pension overhaul may prolong a selloff in state bonds that began in May, when lawmakers failed to extend a 2011 income-tax increase. That leaves the state with a $2 billion hole that will require stiffing vendors, borrowing money and delaying payments to employees.

The extra yield municipal-bond investors demand to own Illinois general obligations instead of benchmark AAA munis rose yesterday to 1.28 percentage points, the highest since February, according to data compiled by Bloomberg. Illinois has the lowest rating among U.S. states and the widest yield spread among the 17 states tracked by Bloomberg.

Lawsuits Reinstated

Today's ruling reinstates lawsuits filed by members of three Illinois employee unions. Those cases had been dismissed by a state court judge in Sangamon County, which includes the state capital of Springfield.

The ruling supports the argument that “retirement security, including affordable health care and a modest pension, cannot be revoked by politicians,” Henry Bayer, executive director of the Illinois chapter of the American Federation of State, County and Municipal Employees, said in a statement.

The ruling will have no direct impact on the pension reform litigation arguments, said Maura Possley, a spokeswoman for state Attorney General Lisa Madigan.

“While this decision is very clear on the fact that the pension clause covers health care benefits, the arguments in the pension reform litigation are different than the ones in this health care case,” Possley said.

Ruling Disappoints

Sarah Wetmore, vice president and research director at the non-profit Civic Federation in Chicago, said her organization was disappointed with the high court ruling.

“The Civic Federation supported the changes that the state had made to retiree health-care subsidy, that they were necessary and rational to make the program more sustainable over the long-term,” she said in a phone interview.

“We think this means the state is going to have to come up with a plan to make those payments going forward, whether that means cutting in other areas or raising additional revenue. It’s an expensive program for the state and it’s going to become more expensive in the future,” she said.

Wetmore declined to speculate on the effect of today’s decision on the pension reform bill litigation. “It’s certainly not helpful for the state,” she said.

Grant Klinzman, a spokesman for Quinn, said the governor remains confident that the pension reform law is constitutional.

“If the court’s decision is predictive, the challenge of reforming our pensions will remain,” Illinois Senate President John Cullerton said in a statement.

Cullerton and Quinn are Democrats.

Those pursuing the health insurance-premium claims are members of the Illinois’ State Employees Retirement System, the State Universities Retirement System and the Teachers’ Retirement System of the State of Illinois.

The case is Kanerva v. Weems, 2014-IL-115811, Illinois Supreme Court (Springfield).

By Andrew Harris Jul 3, 2014 1:32 PM PT

To contact the reporter on this story: Andrew Harris in federal court in Chicago at aharris16@bloomberg.net

To contact the editors responsible for this story: Michael Hytha at mhytha@bloomberg.net Joe Schneider, Fred Strasser

---

Moody's: New Pension Disclosures Under GASB 67/68 Will Have Limited

Impact on US State and Local Government Ratings.

New York, June 30, 2014 — The new state and local government pension accounting standards, Government Accounting Standards Board (GASB) 67 and 68, scheduled to start later this year, will not change the methodology that Moody's Investors Service uses to adjust US state and local government pension data in its rating process. Some liability measures could be affected, however, by new information in the additional disclosure that the standards will require, specifically on the sensitivity of liabilities to changes in the discount rate.

Moody's explains the impact of the GASB 67/68 reporting changes on its credit analysis in the report, "Moody's US Public Pension Analysis Mostly Unchanged By New GASB 67/68 Standards."

"The revised standards do not change our approach to calculating Moody's Adjusted Net Pension Liability, or ANPL, for state and local governments, the measure of these liabilities that we use in our ratings," says Analyst Tom Aaron. "The new information that will be disclosed on the sensitivity of discount rates, however, could materially impact the results of our adjustments in some cases."

The additional disclosure is unlikely to impact ratings in the vast majority of cases, says Moody's. When it does, the information could be credit positive or credit negative, depending on pension plan liability characteristics.

Moody's will use the new liability disclosure related to discount rate changes for estimating the specific duration of a given plan. Absent other data, Moody's had previously assumed a uniform plan duration of 13 years in making its discount rate adjustments to plan liabilities.

Moody's will continue to adjust reported liabilities in their entirety using a high-grade corporate bond index tied to the actuarial valuation date.

Important changes in GASB 67/68 that will not change Moody's pension adjustments include the disclosure of local governments' shares of a multi-employee cost-sharing plans, and the appearance of net pension liabilities on local government balance sheets.

The accounting standards will change with pension plan disclosures for fiscal year 2014 and bond issuer disclosures for fiscal year 2015.

For more information, Moody's research subscribers can access the report at:

http://www.moodys.com/viewresearchdoc.aspx?docid=PBM_PBM171874.

***

NOTE TO JOURNALISTS ONLY: For more information, please call one of our global press information hotlines: New York +1-212-553-0376, London +44-20-7772-5456, Tokyo +813-540--4110, Hong Kong +852-3758-1350, Sydney +61-2-9270-8141, Mexico City 001-888-779-5833, São Paulo 0800-891-2518, or Buenos Aires 0800-666-3506. You can also email us at mediarelations@moodys.com or visit our web site at www.moodys.com.

Thomas Aaron
Analyst
Public Finance Group
Moody's Investors Service, Inc.
100 N Riverside Plaza
Suite 2220

Chicago, IL 60606
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Timothy F Blake
MD – Public Finance
Public Finance Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

WSJ: Illinois Supreme Court Rules Against Cuts in Retiree Health Benefits.

CHICAGO—A ruling by the Illinois Supreme Court Thursday is casting new doubts on an overhaul of the public employee retirement system that passed last year to prop up the state's deeply underfunded pensions.

The court ruled health-insurance subsidies for retired state workers are protected under the Illinois Constitution, siding with public-sector unions who challenged cuts to the benefits passed by lawmakers two years ago. The decision set off renewed debate over the constitutionality of a larger overhaul of the retirement system, which passed last fall and is being challenged by state workers and retirees on similar grounds.

"If the court's decision is predictive, the challenge of reforming our pension systems will remain," state Senate President John Cullerton said.

Gov. Pat Quinn stood by the pension law, which reduces future retirement costs by shrinking cost-o--living increases for retirees, raising retirement ages for younger employees and capping the size of pensions. He said he expects the law will survive the legal challenge that's pending.

The pension changes came after nearly three years of grueling debate, during which the state's credit rating fell to the lowest among U.S. states. Illinois has underfunded its retirement system for decades, and the shortfall has grown to $100 billion. Chicago also is watching state-level decisions that could affect the city, which is trying to close its own yawning gap between current assets and promised retirement benefits.

Courts are playing a key role in several states in determining just how far lawmakers can go in cutting pension benefits for workers and retirees as they try to stabilize funds and reduce future costs.

In Illinois, lawyers for state workers and retirees took Thursday's decision as a sign the state's top court will hold true to the constitution, which explicitly forbids the diminishment of pension benefits once they're promised. But Illinois Attorney General Lisa Madigan in a statement said the arguments are different in the larger pension overhaul case and aren't directly affected by Thursday's ruling.

A spokeswoman for Chicago Mayor Rahm Emanuel said the court ruling doesn't affect city efforts to address pension or health-care costs.

Still Christopher Mooney, director of the Institute of Government and Public Affairs at the University of Illinois, said the 6-1 ruling likely means the court will scrap the larger overhaul. The case for allowing reductions in health benefits was stronger than what the state will argue when defending the larger cuts in pension benefits, he said.

"We're basically back to square one. They are going to have to figure out something else," he said.

Illinois's 10-year general obligation bonds were unchanged Thursday, according to Thomson Reuters Municipal Market Data. Trading was light ahead of the Independence Day holiday.

By MARK PETERS
Updated July 3, 2014 4:23 p.m. ET

Write to Mark Peters at mark.peters@wsj.com

WSJ: Creditors Win Bid to Challenge Detroit Bankruptcy.

DETROIT—A legal challenge in Detroit's municipal bankruptcy case must be heard before a trial on the city's debt-cutting plan, a federal appeals court ruled late Wednesday.

The Sixth Circuit Court of Appeals said a lower district court judge improperly held up an appeal by municipal bond insurer Syncora questioning the city of Detroit's use of casino tax revenue during the case.

"In a bankruptcy case of such scope and complexity, that is not the proper way to adjudicate appeals that implicate legal questions of fundamental importance to the bankruptcy proceedings," the 6th Circuit Court of Appeals said in its ruling.

By ordering the lower court to act, a federal appeals court may have thrown a potential wrench in the timetable to exit the city of Detroit from municipal bankruptcy by this fall.

The appeals court ordered a federal-district court judge to rule by July 14 on a request by Syncora Guarantee Inc. and its associated Syncora Capital Assurance Inc. to stop the city from using its casino tax revenue rather than preserve the funds potentially to pay back creditors including Syncora. The city generates about $170 million a year from taxes levied on its three casinos.

"Without a final decision on that question, the city will not know what amount its coffers will contribute to the bankruptcy estate, the creditors cannot know the size of the pie they are being asked to share, and the bankruptcy court cannot be confident that it is considering a legally and financially viable plan," the appeals court said Wednesday.

A trial before a federal bankruptcy judge on the city's proposed debt-cutting plan to resolve an estimated $18 billion in long-term obligations is scheduled to begin Aug. 14. It wasn't immediately clear whether the appeals court ruling would push back the beginning of the trial in the nation's largest municipal bankruptcy case. The city's emergency manager had hoped to see the city exit Chapter 9 bankruptcy by the end of September when his term is set to end.

A representative for Syncora didn't have an immediate comment.

Bill Nowling, spokesman for Detroit Emergency Manager Kevyn Orr, said in an email Wednesday night that "it is too soon to say what impact (the ruling) could have on the length of the bankruptcy proceedings."

Detroit made ill-fated interest-rate bets known as swaps with Wall Street banks in the hopes of avoiding higher rates. They were tied to $1.4 billion in bonds the city issued from 2005 to help address funding shortfalls in its pension funds.

In 2009, to escape default on the original deal, the city pledged the casino tax revenue as collateral. When the city filed for bankruptcy, other creditors including Syncora tried to stop it from getting casino-tax revenue, which the city says it needs to stay afloat.

By MATTHEW DOLAN
Updated July 3, 2014 9:39 a.m. ET

Write to Matthew Dolan at matthew.dolan@wsj.com

Muni Takeaways From the Morningstar Conference.

Muni managers take sides in the Puerto Rico debate, address the bond landscape in Chicago, Detroit, and California, and discuss the advantages of CEFs in the muni space.

Last week, Morningstar hosted the 26th annual Morningstar Investment Conference. During the conference, attendees heard keynotes from some of the industry's highest-profile fund managers, including Franklin Templeton's Michael Hasenstab, PIMCO's Bill Gross, and AQR's Cliff Asness. While these speakers didn't disappoint, several of the most interesting and engaging conversations happened between keynotes in more intimate panel discussions. On June 20, I moderated a panel with three prominent municipal bond managers to discuss the current market, where they see opportunities, and why closed-end funds can be great vehicles for municipal bonds.

The panelists included John Miller, co-head of fixed income and head of munis at Nuveen Investment, Rob Amodeo, head of municipals at Western Asset Management, and Joe Deane, head of municipal bonds at PIMCO. These three managers run billions of dollars in municipal bond assets and have decades of experience in the asset class. Each runs both open-end and closed-end municipal bond funds.

Puerto Rico: The Great Divide

The hottest topic of the day was Puerto Rico. Deane wasn't shy about his negative view of the territory. He noted that it is the third largest-municipal issuer, behind California and New York, but it's a "small island in the Caribbean" with a tiny population relative to other large issuers. He pointed to a "brain drain" on the island as a major stumbling block to any recovery. Because Puerto Ricans are citizens of the United States, many highly educated residents have left for places like Miami and New York City because of better job opportunities. PIMCO no longer holds any Puerto Rico bonds.

Though Amodeo admitted that Puerto Rico has its problems, he believes COFINA bonds (sales-ta--backed bonds) are worth holding. According to Amodeo, those bonds bring in $1.3 billion in revenue to cover $700 million in debt service. In the past, government corruption meant that a good portion of tax revenue went missing, but Amodeo pointed to new measures put in place that he believes will make it more difficult for politicians to divert the revenue.

Miller agreed with Deane that Puerto Rico had high hurdles to overcome and noted that after issuing nearly $4 billion in bonds just a few months ago, the territory is once again facing liquidity issues. Miller, however, agreed with Amodeo that COFINA bonds were the best to own on the island, and, as of May 30, some of his portfolios held those bonds.

Chicago, Detroit, and California

After a lively debate over Puerto Rico, the panelists were largely in agreement over the situations in Chicago, Detroit, and California. Miller, who lives and works in Chicago, believes that while it has big problems with its pension liabilities, the city can still right its course. In his opinion, the city has two options to deal with the unfunded (and constitutionally guaranteed) pensions: raise taxes or cut pension benefits. He says Chicago mayor Rahm Emanuel is hesitant to take either path and has, so far, pushed back on the governor of Illinois for reforms at the state level. As for his investments, Miller likes general-obligation bonds backed by Assured Guaranty and bonds issued by the Chicago Transit Authority.

Turning to Detroit, Amodeo noted a “reranking of risk” regarding the city’s general-obligation and revenue bonds. Historically, general-obligation bonds have been considered safer than revenue bonds and have been priced to reflect that relative safety. The Detroit bankruptcy has challenged that assumption. The city’s revenue bonds (specifically, water and sewer bonds) are in better shape than its general-obligation bonds, the holders of which are likely to receive less than full value for those bonds. Amodeo does hold water and sewer revenue bonds from Detroit in his portfolios.

Finally, Deane pointed to California as a success story in the muni market. A few years ago the state was facing massive budget issues, but fiscal belt-tightening stopped the bleeding, leaving the state’s finances in much better shape. He believes those actions provide a blueprint for other cities and states in similar situations.

Advantages of CEFs

All three panelists agreed that there are many advantages of investing in municipal bond closed-end funds. First and foremost, the funds’ closed structures are a positive. Because closed-end funds aren’t subject to investor flows, for example, Amodeo says that he can invest in illiquid securities that offer higher yields than comparable, more-liquid holdings. In the same vein, Miller said that when open-end funds are selling to meet investor outflows, he snaps up deeply discounted securities.

Deane spoke of the advantages of leverage, but also warned of the added volatility. A positive-sloping yield curve is advantageous to leveraged funds, which can borrow at lower short-term rates and invest in higher-yielding, longer-term securities. This comes with added risk of volatility, especially because the funds may hold long-duration securities. However, Deane believes that over time, leverage will work to an investor’s advantage if he or she is willing to weather the volatility. Finally, Amodeo noted that, from an investor’s perspective, the ability to purchase shares when they trade at a discount is a nice advantage. He also said that he snapped up shares of his own municipal CEFs last year when discounts gapped out.

Final Thoughts

Amodeo is avoiding tobacco bonds because of concerns over high taxes on cigarettes as well as the competition from e-cigarettes. His firm is also cautious on toll roads because he believes more drivers are weighing the cost of drive time versus paying the toll.

Miller discussed some of the supply issues the industry has been facing and believes those issues will lead to much lower supply this year. Miller says municipalities are loath to take on more debt, slowing new issuance, and continued low interest rates will lead to fewer repricings this year.

Deane prefers revenue bonds to general-obligation bonds, arguing that unfunded pensions will cause big problems for states and cities to deal with over the medium term. He noted specifically that a change in accounting rules for pension liabilities may create major problems for city and state balance sheets. In the past, cities and states could pick a funding ratio used to calculate the unfunded liability (the higher the number, the lower the calculated obligation). But new accounting rules will force cities and states with unfunded pensions to use a predetermined number, which is likely to be much lower than the ratio they are currently using. This change would cause the reported unfunded liability to go up, creating an even larger hole for cities and states to dig out of.

Finally, all three panelists agreed that tax reform regarding municipal securities is not a near-term concern, as the coming election and partisan climate in Washington make a consensus on tax reform extremely unlikely.

In all, the panelists were constructive on the muni market with reservations about certain sectors and locations.

By Cara Esser | 06-27-14 | 06:00 AM |

About the Author: Cara Esser is a senior fund analyst on the active funds manager research team for Morningstar and heads up the team's coverage of closed-end funds.

S&P: U.S. State Pension Funding: Strong Investment Returns Could Lift Funded Ratios, But Longer-Term Challenges Remain.

U.S. state pension funded levels continue to decline but have likely bottomed out as the effects of the 2008 and 2009 equities market downturn make their way out of the valuations, according to Standard & Poor's Ratings Services' 2014 annual survey. Strong market performance in 2013 and 2014 coupled with a shift to market valuation of assets will probably contribute to improved funded ratios in the near future. Although this is likely the low point, which is good news, we believe pension funded level recovery could be slow and uneven and sizable funding gaps will remain for most states. While reform efforts continue, which will help over the long term, we see continued pressure related to market volatility, increased competition for limited state financial resources, and changes in actuarial assumptions.

In our view, factors that will contribute to significant fluctuations to pension funded ratios include:

- Potential for increased market volatility as we reach the fifth year of a bull market in equities and record highs in the S&P 500 Index and the Dow Jones Industrial Average;
- Greater investment risk-taking to compensate for previous market losses, which could lead to greater asset performance volatility;

- Implementation of Governmental Accounting Standards Board (GASB) Statements 67 and 68;
- Changes to assumptions based on economic conditions and experience studies;
- Ongoing pension reform efforts; and
- For states with weaker funded systems, a problematic funding environment as growth in pension contributions consumes a larger part of their budgets.

Read the full Report.

U.S. Public Pension Funding Gaps to Widen Under New Rules.

Some U.S. public pensions, which lack savings for $1.4 trillion of promises to retired government workers, will record wider gaps in fiscal years starting after July 1 because of changes in accounting rules.

Pensions in Illinois, Kentucky, Pennsylvania and other states will see funded levels decline, in some cases by more than half, as they comply with new Governmental Accounting Standards Board rules that for the first time will require future pension costs to be included on balance sheets and change how they must calculate their underfunding.

The new rules won't affect the amount that states and municipalities actually owe, though they could prompt them to address their underfunding, said Dean Mead, research manager at the Norwalk, Connecticut-based board known as GASB, which makes accounting rules used by most governments. The changes may force some states to cut borrowing or spending.

"It could affect their policy decisions," Mead said in a telephone interview. "It's their choice how to react to the new numbers."

Under the new rules, governments will have to calculate an estimate of how much they owe for future pension liabilities and put that on their balance sheets. Under current rules they put estimates in footnotes on financial statements. Some plans predicted to run out of money will have to lower investment return assumptions used in calculating their future costs, making their liability seem larger.

Funding Adjustments

"They may not want to discuss these numbers," said Keith Brainard, the Georgetown, Texas-based research director with the National Association of State Retirement Administrators in Washington. "Because of these new numbers, some policy makers will make funding adjustments so they won't look so bad."

Teachers Retirement System of the State of Illinois could see its funded level decline to 17.5 percent from 48.4 percent under the changes, according to 2012 estimates from the Center for Retirement Research at Boston College.

Illinois Teachers doesn't agree with the estimates, said spokesman Dave Urbanek. The only effect of the new GASB rules will be that the fund will have to report a new number. Though the pension has earned 9 percent on average in the past 30 years, the state has never fully funded the plan since it was created in 1939, he said.

"We will have a full range of unfunded liabilities that people can pick from," said Urbanek. "The bottom line is that we have a problem."

Fixes Made

Funding for the Kentucky Employee Retirement System would decline to 23.7 percent from 40.3 percent, according to the Boston College estimates.

Executive Director William Thielen said by e-mail that he wasn't aware that the changes would affect the funding ratio. The rules will require the fund to use new reporting terms and "include significantly more information" in financial reports, he said.

Some municipalities have taken action to try to increase funding ahead of the new rules taking effect: Alaska moved $3 billion from its rainy day fund to shore up pensions. California passed legislation to close a $74 billion gap in the California State Teachers' Retirement System.

The new numbers may not affect debt costs in the $3.7 trillion municipal bond market because of limited supply and small differences in yields between issuers, said Richard Ciccarone, president of Merritt Research Services in Chicago. Still, borrowers that don't address shortfalls may eventually be penalized, he said.

"Over time, as the pension crisis continues, you're going to see spreads widening," Ciccarone said.

By Darrell Preston Jun 26, 2014 9:00 PM PT

To contact the reporter on this story: Darrell Preston in Dallas at dpreston@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Michael B. Marois, Mark Schoifet

---

Moody's: US Nuclear and Coal-Fired Power Plant Retirements to Jolt Some Local Governments.

New York, June 18, 2014 — Aggressive changes to environmental and safety policies combined with abundant, cheap natural gas will trigger the largest wave of electric generating plant retirements in the US in 35 years, says Moody's Investors Service in a new report. Moody's has identified the 10 US local governments it rates that are most exposed to credit risk from these closures. The risk is already captured in their ratings, although ratings could change as new information about possible closures develop.

"The retirement of large-scale, base-load nuclear and coal-fired plants will have a significant impact on many local governments, as power plants are often the top taxpayer for a city, county, or school district, paying a larger share of property taxes than the government's other companies and individual residents," say Moody's Associate Analyst Andrew Pfluger and Vice President/Manager Julie Beglin in the report "US Nuclear and Coal-Fired Power Plant Retirements to Jolt Some Local Governments."

Leading the list of Moody's-rated local governments that receive the greatest share of their revenues from payments by a plant at risk for closure or already scheduled for retirement are Hendrick Hudson Central School District, Westchester, NY (general obligation debt rated A1), which receives 30.9% of its operating revenues from the Indian Point nuclear plant; Mexico Central School District, NY (A1), which receives 27.3% of its operating revenues from the James A. Fitzpatrick nuclear plant; the Town of Ontario, NY (Aa2), which receives 25.8% of its operating revenues from the R.E. Ginna nuclear plant; and the Town of Somerset, MA (Aa2), which receives 20.1% of its revenues from the Brayton Point coal plant.

The other local governments on the list are Wayne Central School District, NY (Aa3); Lacey Township, NJ (Aa3); Putnam County School District, GA (Aa3); Plymouth (Town of), MA Aa2); Kewaunee (County of) WI (A1); and Mount Holly (City of) NC (Aa3).

The 10 most-exposed rated local governments average 14% of their total operating revenues from at-risk power plants. Of the five most exposed local governments, four receive an average of 25.3% of their total operating revenues from at risk nuclear power plants, compared to 20.1% for the coal-fired plant. Nuclear power plant retirements may have a greater net credit impact on local governments than coal-fired power plants in terms of tax base and employment, says Moody's, because of their typically larger scale.

Although a retiring plant may present significant credit risk, local governments often benefit from several mitigants that soften the impact. These include strong reserves, conservative budgetary practices, ability to secure alternate sources of revenue, alternative use of plant sites, and assistance from state legislatures to ease the transition.

For more information, Moody's research subscribers can access this report at www.moodys.com/research/PBM_PBM169742.

***

NOTE TO JOURNALISTS ONLY: For more information, please call one of our global press information hotlines: New York +1-212-553-0376, London +44-20-7772-5456, Tokyo +813-540--4110, Hong Kong +852-3758-1350, Sydney +61-2-9270-8141, Mexico City 001-888-779-5833, São Paulo 0800-891-2518, or Buenos Aires 0800-666-3506. You can also email us at mediarelations@moodys.com or visit our web site at www.moodys.com.

Andrew Pfluger
Associate Analyst
Public Finance Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Julie A Beglin
Vice President – Senior Analyst
Public Finance Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007

U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Fitch: Florida School Funding Shifting Toward Local Taxes.

Fitch Ratings-New York-26 June 2014: Florida's shift toward greater dependence on local taxes and modest increase in per-pupil funding are neutral for the state's local school district credit quality, Fitch Ratings says. The move away from reliance on state appropriations is included in the state's 2015 budget.

The budget raises the state's per student funding total only modestly, to $6,937 or 2.6%. Total school funding grows a slightly stronger 3.1%. Per student funding has grown consistently since fiscal 2012 but remains below the fiscal 2008 peak. It will likely take years of more sizable funding growth to keep up with current cost pressures and restore downsized operations and reserves from past budget cuts.

The Florida Education Finance Program (FEFP), the primary mechanism to finance operating costs of Florida K-12 schools, is funded through a combination of state appropriations and local funding. The latter derives exclusively from property taxes levied by each individual school district.

Local school property taxes aggregating to $8.2 billion are budgeted to generate about $400 million or 70% of the $575 million increase in FEFP funding. The state's $10.6 billion contribution still represents the majority of FEFP funding but the gap is narrowing. The local funding boost is facilitated by a 5.4% uptick in aggregate school district taxable values while the average school property tax rate holds steady at last year's 5.9 mills.

Fitch expects the growth in the tax base to enhance school districts' ability to fund needs subsidized through property taxes that are not factored into the FEFP, such as capital projects, facility maintenance, and debt service.

Contact:

Larry Levitz
Director
U.S. Public Finance
+1 212 908-1174
33 Whitehall Street
New York, NY

Rob Rowan
Senior Director
Fitch Wire
+1 212 908-9159

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

Fitch: Proposed Fund Balance May Pressure CA School Districts.

Fitch Ratings-New York-25 June 2014: A number of California school districts could see their credit quality weaken if a fund balance cap included in the fiscal 2015 budget becomes effective, Fitch Ratings says. Gov. Jerry Brown signed the education trailer bill to the budget last week that contains the cap. It will only become effective if the state's rainy day reserve (which includes a school funding reserve) constitutional amendment is approved by voters in November. If approved, it is not expected to be implemented until after fiscal 2018.

Even before the cap is triggered, Fitch expects some increased pressure by stakeholders to draw down reserves in anticipation of the cap being applied, which may result in some credit quality deterioration.

If applied, the cap would limit most school districts' assigned and unassigned general fund balances to 6% of expenditures. The current minimum is 3% of expenditures. The 6% cap would be well below the median Fitch-rated California school district balance of 20% and we view it as low, given the volatile history of California's K-12 funding system. Fitch believes that could also result in liquidity pressures.

There are potential mitigants to these risks. The school funding reserve ought to dampen funding volatility somewhat, reducing the concern about lower fund balances. Both budgetary and cash flow concerns could be mitigated by district's ability to maintain reserves outside the general fund to which the cap would not apply. Finally, districts may apply for exemptions from the cap if they provide a reason for needing additional funding, such as for capital or other long-term needs.

Contact:

Karen Ribble
Senior Director
U.S. Public Finance
+1 415 732-5611
650 California Street
San Francisco, CA

Rob Rowan
Senior Director
Fitch Wire
+1 212 908-9159

33 Whitehall Street
New York, NY

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com.

The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

WSJ: Tobacco Bonds Feel Heat From E-Cigarettes.

Hit to Traditional Cigarette Sales Threatens Revenue Flows that Back Securities

John Miller isn't quitting tobacco bonds, but the growth of electronic cigarettes means he might get burned.

Mr. Miller, co-head of fixed income at Nuveen Asset Management LLC, which oversees about $90 billion in municipal bonds, is among those buying even as a steeper-than-forecast drop in smoking and the increased popularity of e-cigarettes threaten the revenue that backs the securities. In 1998, tobacco companies agreed to settle lawsuits by paying states to offset the health-care costs of smoking, with the payments based on shipments of cigarettes.

Some states and municipalities from New Jersey to California sold tax-exempt bonds backed by that money, including many zero-coupon bonds that don't pay interest until maturity. The settlement was reached long before the existence of e-cigarettes, which aren't included in any payments.

Mr. Miller still sees the debt as a bargain, saying borrowers will have plenty of cash to make scheduled interest payments even if smoking continues its decline. He has spent about $50 million to add California tobacco bonds to the Nuveen High Yield Municipal Bond Fund this year. Mr. Miller likes the fact that the bonds are easily tradable even though declines in smoking mean he risks not being paid back on schedule.

"Estimates of the average lives of the bonds and final maturities can lengthen and shorten depending on a variety of events, e-cigs being just one, but are very likely to be repaid eventually given enough time," he said.

He isn’t alone. Bill Gross’s Total Return Fund, the largest bond fund in the world with $229 billion in assets, holds about $301 million of tax-exempt debt from Ohio’s Buckeye Tobacco Settlement Financing Authority, as well as tobacco bonds from California and West Virginia. The Pacific Investment Management Co. fund increased its exposure to tobacco bonds in 2013, according to Morningstar Inc. data. A high-yield fund at BlackRock Inc. increased its exposure to tobacco bonds in the first four months of this year, according to Morningstar.

“Tobacco bonds can provide yield in a low-rate environment, and the sector offers some liquidity at a time when supply is scarce,” said Timothy Milway, a director and credit analyst at BlackRock. Pimco didn’t respond to a request for comment.

The interest in the junk-rated securities underscores the risk some investors are taking in a bid to boost income at a time of low interest rates and uneven economic growth. High-yield debt backed by tobacco companies’ settlement payments is the best performing sector in the $3.7 trillion municipal-bond market. It has returned 16.5% this year, which includes price appreciation and interest payments, compared with 9.3% for all below-investment-grade municipal bonds, according to Barclays.

Still, the $87 billion tobacco-bond market has been hit in recent years by faster-than-expected declines in smoking, which has reduced payments. Now, some analysts said the rise of electronic cigarettes could lead to further shortfalls and eventual defaults by tobacco-bond issuers.

The prospectus for a 40-year tobacco bond issued by Ohio in 2007 was among those that cited a study estimating a 1.8% annual decrease in cigarette use. Instead, consumption has declined at an annual average of 3.3% since 2000, according to Moody’s Investors Service, which said in 2012 that about three-quarters of the tobacco bonds it rates may default if smoking continues to decline at 3% or 4% a year.

In a report last month, Moody’s said that the rapid growth of electronic cigarettes and other smokeless tobacco products could further reduce cigarette shipments. The market for electronic cigarettes and other vaporizing devices is expected to reach $2.5 billion this year, up from $1.8 billion in 2013, according to Wells Fargo. The market could surpass the projected $78 billion in sales this year of traditional cigarettes within a decade, according to Wells. That has got tobacco makers, including Altria Group Inc., Reynolds American Inc., and Lorillard Inc., moving into the market.

“Over the years, we’ve witnessed demand for combustible cigarettes drop steadily year in and year out, and that’s prior to the introduction of what can be considered a competing product,” said Robert Amodeo, head of municipal debt at Western Asset Management Co., which manages about $30 billion in state and municipal debt and doesn’t hold tobacco bonds.

Others said the price of the securities already accounts for the growth of electronic-cigarette alternatives. “The amount of stress, both from the decline in consumption as well as the prospects of the competition of e-cigarettes, is priced into the marketplace in our view,” said Hector Negroni, co-founder of hedge fund Fundamental Credit Opportunities in New York. He declined to discuss the fund’s tobacco holdings.

Credit-rating firms in 2003 downgraded a variety of tobacco-settlement bonds, leading investors to sell the bonds and states to delay issuing new debt. States have since adjusted expectations for smoking declines when selling bonds or refinanced debt to account for drops in traditional cigarette sales. In March 2012, Alabama sold about $93 million in tobacco debt, maturing from one to nine years, that will default only if sales fall more than 25% each year. Minnesota and Illinois have also sold bonds that can withstand declines of about 9% a year.

Bill Newton, acting director of finance for the state of Alabama, said the bonds refinanced existing tobacco debt at lower interest rates after data predicted continuing declines in smoking. Electronic cigarettes weren't considered, he said.

Not all observers believe that usage of e-cigarettes will continue to increase. Morgan Stanley said in an April report that electronic cigarettes "are clearly not a disruptive technology."

Meanwhile, lawmakers in states including New Jersey and Minnesota are taking measures to tax electronic cigarettes like traditional tobacco products, which could reduce growth.

"Something that might slow this down is if more legislation gets implemented to tax or ban e-cigarettes, which would be beneficial to the sale of combustible cigarettes," said BlackRock's Mr. Milway.

By AARON KURILOFF
Updated June 24, 2014 9:05 p.m. ET

GFOA: City of Junction City, Oregon, wins the Cash Basis Award.

"The GFOA Award Program for Small Government Cash Basis Reports is happy to announce a first-time winner of the award – the City of Junction City, Oregon. Receiving this award demonstrates the

exceptional dedication that the City of Junction City has to transparency, accountability, and financial reporting on a modified cash basis. All staff involved in attaining this distinction for the city should be commended for their accomplishment. Congratulations!

The Award Program for Small Government Cash Basis Reports aims to improve the quality and consistency of financial reporting for small governments. It is designed for the thousands of small governments for which financial reporting in conformity with generally accepted accounting principles (GAAP) is not a viable option. For some participants, the program may be a first step toward GAAP financial reporting.

Go to the Award Program webpage to download an application on the program. Checklists are also available for general-purpose governments, school districts, and stand-alone business-type entities, along with a sample small government annual financial report. Questions? E-mail cashbasis@gfoa.org. For information on volunteer opportunities, e-mail cashbasisreview@gfoa.org.

Download Report

Monday, June 23, 2014

The Road Hazards Ahead for Transportation Funding.

A decade-long revenue decline is about to get worse.

The U.S. Department of Transportation says balances in the federal Highway Trust Fund will drop so low next month that payments to states for work already underway will be delayed. Meanwhile, the Congressional Budget Office warns that trust-fund balances will be entirely depleted by 2015, putting funding for new projects at risk as well. To add to the uncertainty, the federal surface transportation measure known as MAP-21, which authorizes funding for state and local projects, expires Sept. 30.

Highways, bridges, passenger rail and public bus systems depend on a mix of federal, state and local support. If any element falters, the entire system is weakened, with risks to both passenger safety and economic growth. The federal government has provided roughly a quarter of all highway and transit funding (including both capital investment and operations), and some states rely on the federal government for as much as 40 percent. For these states, a depleted Highway Trust Fund and uncertainty about MAP-21 create major fiscal challenges.

Over the past decade, gas-tax revenues, one of the largest transportation revenue sources, have fallen substantially on an inflation-adjusted basis across federal and state governments as a result of increased vehicle fuel efficiency and changed driving habits. At the federal level and in most states, gas taxes have remained at a fixed amount per gallon even as transportation construction costs have risen. This has contributed to a 25 percent decline in states' own transportation funding.

This story line runs from coast to coast. Maine's state gas- and vehicle-tax revenue has declined by 7 percent since 2001, adjusting for inflation. Its gas tax as a share of the price of gasoline has dropped by more than a fifth. Meanwhile, according to Federal Highway Administration data, 30 percent of road-miles in the state are rated as "poor" and 30 percent of its bridges are considered structurally deficient or functionally obsolete. Nebraska's state gas- and vehicle-tax revenue has declined by 26 percent, while 11 percent of road-miles in the state are rated as "poor."

Oregon residents have special reason to fret about the shrinking federal Highway Trust Fund. A study by the Pew Charitable Trusts showed that the Beaver State is among those that rely the most on the federal trust fund, receiving 36 percent of its highway and transit dollars from the fund in 2011, the latest year for which comprehensive data are available. Oregon officials warn that the state could lose $150 million or more annually if Congress doesn't find a way to prop up the trust fund.

Even states that have added new ways to finance transportation projects will still need federal dollars. Colorado, for example, raised vehicle-registration fees and formed public-private partnerships but continues to rely on federal support for almost a third of its highway and transit budget.

As states wrestle with difficult questions raised by aging or inadequate highway and transit systems, it becomes more and more important for them to contemplate different funding options and the need to prioritize projects. In addition, state leaders must better communicate concerns and ideas to members of Congress and to relevant committee staffs on both sides of the aisle as federal policymakers consider options for addressing the shortfalls in the Highway Trust Fund.

Funding challenges in the nation's transportation systems will require both elected leaders and voters to recognize the role that each level of government plays in supporting this critical infrastructure. Public safety and economic growth are at stake.

BY SUSAN K. URAHN | JUNE 25, 2014

RBC Capital Markets State Economic Heat Map – Q1, 2014.

In RBC Capital Markets' heat map for states, analyst Chris Mauro noted that recent statistics point to a slowdown in economic development in many states. "The first quarter of 2014 continued the trend of softer economic data with only five states moving to a higher tier in our Heat Map and seven states moving to a lower one," Mauro wrote. However, this year's there's been a shift. This time the weakness throughout the quarter came from a mix of states in the Midwest and the South (which typically post stronger economic growth numbers), while most of the improvement came from states in the Northeast. Part of the reason is likely because of lower crop prices, which severely affected on farm income in the Plains states. The plunge in farm income knocked North Dakota from the RBC's top tier, for example. Housing prices in some areas continued to rebound as eight states posted a larger than 10 percent gain in the first quarter compared to the first quarter of 2013. Nevada and California led the charge, each with gains of 19 percent.

View the Report.

S&P: U.S. Charter School Ratings Continued to Slip as 2013 Medians Sent Mixed Signals.

The number of charter schools that Standard & Poor's Ratings Services rates has continued to grow since our last report on the sector's median performance ratios (see "Charter School Medians Reflect Operating Pressures In A Growing Sector," published June 27, 2013). Most of the growth has been in the 'BB' category ('BB+', 'BB', and 'BB-'), as it was in the previous year, and we've downgraded a number of schools to speculative-grade as well. We believe this increase at the lower end of our rating scale reflects the culmination of years of per-pupil funding cuts and the resulting pressure on schools' operations, along with increased competition in some markets. In addition, schools are entering the capital markets and requesting ratings earlier in their lifecycles.

For these reasons, we anticipate that ratings will continue to move to the lower end of our rating spectrum, and our outlook on the sector remains negative overall (see "The U.S. Charter School Outlook Is Still Negative in 2014," published Feb. 24, 2014 on RatingsDirect). Of our 214 public charter school ratings, currently, 41 (19%) have negative outlooks while only 5 (2%) are positive. Although funding may be beginning to stabilize in many states, it generally hasn't returned to pre-recessionary levels, and some schools are struggling to operate in this "new normal."

Overview

- Funding is increasing for charter schools in some states, but many are still struggling from the Great Recession fallout.
- More schools are beginning to issue debt (and request ratings) earlier in their life cycle.
- The portion of charter school ratings at the lower end of the range for this sector continues to rise.
- The sector's medians showed mixed results with weakening financials but increased cash and demand across most rating categories.

Read the Report.

S&P: California County and Local Government Investment Pools Report Few

[Changes Despite Persistently Low Interest and Improved State Revenue in 2014.]

Standard & Poor's Ratings Services' yearly survey of California local county investment pools (LCIPs) and local government investment pools reveals most pool managers expect participants' liquidity demands in the upcoming year to be unchanged or less than previous-year demands. This is mostly due to additional revenue and the budgeted payment of most of the remaining interyear prior funding deferrals disclosed in Gov. Jerry Brown's fiscal 2015 May budget revision (please refer to the article, titled "California Governor's Fiscal 2015 May Budget Revision Proposal Highlights Good News," published May 22, 2014, on RatingsDirect).

Economic growth and the authorization of temporary personal income taxes and sales-and-use taxes have helped bolster California's revenue profile; we expect similar trends to persist through at least fiscal 2015, further supporting the revenue projections included in the governor's May 2015 budget revision. With interest rates expected to remain low and state revenue improvement expected to continue, a significant majority of pool managers cite interest rate risk as their primary concern. Our survey, however, shows few managers have made, or plan to propose, changes to their investment strategy to manage this risk.

Overview

- With state budget improvements, most California investment pool managers expect liquidity demands to remain unchanged or less than previous-year demands.
- Pool managers highlight interest rate risk as a primary concern, but few managers have changed their investment strategy.
- Most investment pools continue to hold a majority of assets in relatively low-risk federal or state agency bonds and investment funds.
- We received responses from 55 of the 58 LCIP managers in California.

Interest Rate Risk Has Not Affected Duration

Consistent with the 2013 survey, the 2014 survey found that 37 LCIPs monitor, and can report, their current portfolio duration. Some LCIPs, however, did not respond to this question. We also asked LCIPs to express the greatest risk they see to the portfolio during the next year: interest rate risk, unplanned liquidity, or underlying investment default. Survey results show that 70% of respondents answered interest rate risk, slightly higher than the 65% that responded similarly in 2013. In addition, all three of the statewide investment pools surveyed cited interest rate risk as the most significant risk they expect for the next year.

From an LCIP standpoint, interest rate risk is the risk that adverse interest rate movement will create a negative effect on investments held in the pool, as a whole. In the low interest rate environment that has persisted for the past several years, interest rate risk means overall market rates in the economy increase, causing a decrease in the value of fixed-income investments. Duration is a measure commonly used to measure interest rate risk.

Although an increasing number of respondents cited interest rate increases as their primary portfolio risk, survey results reveal the average duration among LCIPs monitoring this data remained unchanged from the 1.173 average reported last year; this is only slightly lower than the 1.182 average reported in 2012. Although the average was unchanged, responses show some LCIPs report shorter durations; this is perhaps a better demonstration of their concern that interest rates will likely rise gradually over time. LCIP managers also cited added investment flexibility as one of their reasons for a continued short duration. Such consistency in average duration across all LCIPs, however, further enforces our position that pool managers believe duration is meeting their expectations of adequately matching higher yield and principal preservation despite continued expectations of gradually increasing interest rates.

Asset Allocations Demonstrate Little Change

With consistently low interest rates and higher state revenue, we believe there is an increased likelihood LCIPs could slightly modify their asset allocations in search of additional yield, potentially exposing LCIPs to a modest amount of added risk. The willingness of LCIP managers to take on additional risk in search of added return, however, appears minimal. The 2014 survey found that 56% of LCIPs expect to adjust, or have already adjusted, their investment strategy due to the current interest rate environment. The remaining 44% report no recent or proposed changes. Of those that have changed or expect to change their strategy, most describe the adjustments as more of an effort to rebalance the portfolio as a whole rather than undertake a new or more aggressive investment approach. A handful of respondents who expect lower liquidity needs on the portfolio, however, made corresponding portfolio adjustments to extend the duration of their portfolio modestly.

Just 39% of assets matured in less than 90 days for the fiscal year-ended March 31, 2014, down slightly from 41% in 2013 and consistent with the 39% reported in 2012. In addition, 63% of responses indicated the LCIPs’ largest holdings are federal agency bonds (government-sponsored entities), which generally provide a higher yield and have low-risk characteristics similar to those of treasuries. The second-largest investment was in the state local agency investment fund. The ranking of these two leading categories of investments remains unchanged for the past two years. Similar to last year, on average, LCIPs invest 51% of fund assets in their largest holdings.

Pool Participants*	Book value (Mil$)	Market value (Mil$)	Market-to-book value	Effective duration	Weighted average maturity (days)	Weighted average life (days)	% of assets maturing in less than 90 days

Alameda County	3,577.3	3,573.8	0.999		NP	NP	516.0	42.0

Alpine County	30.7	30.8	1.001		0.38	138.7	138.7	79.8

Amador County	70.2	NP	NP	NP	704.0	NP	35.0

Butte County	412.7	410.9	0.996		1.83	634.0	634.0	32.0

Calaveras County	106.3	106.6	1.002		1.07	416.1	394.2	46.1

Colusa County	48.8	68.5	1.404		0.67	180.0	180.0	84.1

Contra Costa County	2,470.0	2,460.0	0.996		0.50	160.6	N.A.	70.0

Del Norte County	35.1	35.1	1.000		NP	511.0	252.1	60.0

El Dorado County¶

Fresno County	2,443.4	2,456.7	1.005		2.20	895.0	895.0	12.0

Glenn County	59.8	59.7	0.998		1.04	NP	NP	11.0

Humboldt County	311.4	310.3	0.996		0.55	N.A.	804.0	24.0

Imperial County	465.8	466.4	1.001	NP	NP	NP	37.9

Inyo County	114.5	114.2	0.998	NP	846.0	843.2	5.5
Kern County	2,479.0	2,464.0	0.994	0.57	522.0	N.A.	46.0

Kings County	268.2	267.1	0.996		0.63	239.0	739.0	23.3

Lake County¶

Lassen County	70.6	70.6	1.000		0.32	116.0	NP	25.0

Los Angeles County	23,491.2	23,385.5	0.995		1.84	693.0	N.A.	42.9

Madera County	334.9	334.7	1.000		2.27	334.0	828.0	74.8

Marin County	791.1	791.0	1.000	0.21	80.0	235.0	51.1

Mariposa County	27.6	27.5	0.996	N.A.	NP	NP	NP

Mendocino County	198.3	198.4	1.000		0.95	339.5	368.7	48.1

Merced County	637.8	638.0	1.000		1.38	434.0	434.0	46.1

Modoc County	24.3	24.3	1.000	NP	NP	NP	61.5

Mono County	65.8	65.6	0.997		2.00	714.0	NP	8.4

Monterey County	1,013.3	1,010.8	0.997		0.69	485.0	690.0	46.6

Napa County	529.6	527.4	0.996		0.88	338.0	NP	23.1

Nevada County	181.4	181.1	0.998		1.28	571.0	NP	40.2

Orange County	6,890.5	6,891.3	1.000		NP	440.0	443.0	33.0

Placer County	1,116.1	1,111.6	0.996	2.30	NP	1785.0	NP

Plumas County¶

Riverside County	5,256.3	5,248.8	0.999		1.33	500.1	328.1	39.1

Sacramento County	2,389.5	2,390.2	1.000	0.84	311.0	311.0	55.0

San Benito County	94.7	94.9	1.002		1.33	325.0	485.0	29.6

San Bernardino County	5,033.6	5,033.1	1.000		1.02	400.4	386.9	38.0

San Diego County	7,543.4	7,536.1	0.999	0.88	288.0	390.0	35.0
San Francisco City & County	6,725.0	6,717.0	0.999	1.22	708.0	456.3	25.0
San Joaquin County	1,881.5	1,881.7	1.000	NP	NP	284.0	39.0
San Luis Obispo County	595.7	595.7	1.000	NP	205.0	205.0	80.0
San Mateo County	3,333.7	3,331.2	0.999	1.91	715.4	715.4	18.0
Santa Barbara County	1,125.3	1,123.1	0.998	0.69	579.0	NP	31.0
Santa Clara County	4,567.6	4,572.2	1.001	1.00	NP	426.0	24.3
Santa Cruz County	657.4	656.6	0.999	1.62	589.0	589.0	22.0
Shasta County	370.2	368.3	0.995	2.18	785.9	N.A.	11.8
Sierra County	16.0	16.0	1.001	0.54	NP	NP	57.5
Siskiyou County	104.2	103.4	0.992	NP	522.0	890.0	40.5
Solano County	797.9	798.7	1.001	0.88	326.2	305.8	38.2
Sonoma County	1,483.8	1,488.9	1.003	1.51	N.A.	877.0	10.1
Stanislaus County	1,022.4	1,026.2	1.004	NP	545.0	1279.0	20.2
Sutter County	193.5	192.7	0.996	3.93	1303.0	1135.0	16.0
Tehama County	130.3	129.9	0.997	NP	NP	NP	27.0
Trinity County	36.7	36.4	0.991	NP	NP	NP	100.0
Tulare County	1,113.7	1,114.7	1.001	NP	736.0	736.0	25.3
Tuolumne County	117.6	119.2	1.014	NP	564.0	NP	46.0
Ventura County	1,994.4	1,995.0	1.000	NP	346.0	NP	25.5
Yolo County	328.2	328.3	1.000	0.54	198.0	231.0	63.0
Yuba County	296.7	296.3	0.999	NP	425.0	NP	31.2
Average			1.007	1.22	480.1	577.4	38.8
CAMP (statewide)	1,740.5	1,740.6	1.000	0.15	52.9	82.0	64.3
CalTrust Short-Term (statewide)	674.1	674.4	1.001	0.66	368.7	492.4	33.6
CalTrust Medium-Term (statewide)	647.9	649.7	1.003	1.65	609.6	707.0	5.1
PMIA	57,518.5	57,568.2	1.001	NP	NP	185.0	40.1

*All valuation dates are as of March 31, 2014. ¶Not participating. N.A. — Not available. NP — Not provided.

Primary Credit Analyst: Daniel J Zuccarello, New York (1) 212-438-7414;
daniel.zuccarello@standardandpoors.com
Secondary Contacts: Gabriel J Petek, CFA, San Francisco (1) 415-371-5042;
gabriel.petek@standardandpoors.com
Matthew T Reining, San Francisco (1) 415-371-5044;
matthew.reining@standardandpoors.com
Research Contributor: Kaiti Wang, San Francisco (1) 415-371-5084;
kaiti.wang@standardandpoors.com

Record Run Trouncing Treasuries Shows Tax-Free Lure: Muni Credit.

Even when the municipal-bond market loses, it's proving a winner.

Tax-free state and local debt has declined 0.5 percent in June, on pace for the first monthly decline of 2014, Bank of America Merrill Lynch data show. That still leaves the $3.7 trillion market in better shape than Treasuries, which have lost 0.7 percent. Munis are on pace to outperform their federal counterparts in total return for an unprecedented 10th straight month. They're also beating investment-grade company debt.

Tax-exempt borrowings are luring individuals who in April faced levies on bond interest payments as much as 24 percent higher than in 2012. At one point this month, buyers were willing to purchase munis at the lowest yields relative to Treasuries in three years, data compiled by Bloomberg show.

"We just got a kick up in tax rates, and that will bring more people into the market and help it clear at lower ratios," said Phil Fischer, head of muni research at Bank of America in New York. "There's a tremendous amount of demand for munis."

Investors in munis compare yields on state and local securities to those on Treasuries to assess relative value. The ratio for 10-year bonds fell to 86 percent on June 4, the smallest since June 2011, Bloomberg data show. The lower the figure, the costlier munis are relative to Treasuries.

Revealing Ratio

The ratio has averaged 94 percent since 2001, though during the past three years it has typically been about 104 percent. Investors tend to accept lower yields on munis versus Treasuries because of the tax exemption on local debt.

The strongest start to a year since 2009 for munis has pushed the ratio lower. Since Bank of America data on tax-exempt debt begin in 1989, state and local bonds have never outperformed Treasuries for 10 straight months. The previous record of nine lasted from June 2004 to February 2005.

Munis are outpacing this month's 0.6 percent loss on investment-grade corporate bonds, while trailing the 0.6 percent gain for high-yield company securities.

More than half of the municipal market is owned by individuals, who usually buy the debt for tax-free income rather than total returns. The bonds are generally exempt from federal, state and local taxes for residents in most states where they're issued.

‘Key Driver’

Individual investors have added money to muni mutual funds in 18 of 23 weeks this year after a record wave of withdrawals in 2013, when the fixed-income market sold off broadly, Lipper US Fund Flows data show. The revived demand, combined with the fewest new muni sales since 2011, pushed benchmark 10-year yields to a one-year low this month.

“The tax increases have been a key driver on the demand we’ve seen,” said Kevin Ramundo, who helps oversee $28 billion of state and local debt at Fidelity Investments in Merrimack, New Hampshire. “Barring any type of non-muni event, I can see munis continuing to perform quite well.”

This year, high earners faced bills that for the first time include federal tax increases that took effect last year: a top marginal rate of 39.6 percent, up from 35 percent; and a 20 percent tax on long-term capital gains and dividends, up from 15 percent. The top tax bracket is the highest since 2000.

The increases coincide with a 3.8 percent tax on investment income applied to top earners last year as a result of the 2010 Patient Protection and Affordable Care Act.

43.4% Tax

With a top federal tax rate of 43.4 percent when including the new tax on investment income, the 2.4 percent yield on benchmark 10-year munis is equivalent to a taxable interest rate of 4.24 percent.

By comparison, Treasuries maturing in 10 years yield about 2.6 percent. Stated another way, when adjusted to a comparable taxable rate for the highest earners, AAA muni yields are about 160 percent of those on their federal counterparts.

The municipal market “isn’t as cheap as it was,” said Jamie Iselin, head of munis at New York-based Neuberger Berman, which oversees about $9 billion in local debt. “But I also wouldn’t say — especially when you tax-adjust it — that it’s rich either.”

By Brian Chappatta Jun 18, 2014 5:00 PM PT

To contact the reporter on this story: Brian Chappatta in New York at bchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Mark Schoifet

---

Municipal Issuer Brief - June 23, 2014

Read the Brief.

Bond Market Likes Charter School Scores.

The charter school bond market is back, and even a Securities and Exchange Commission action against Chicago-based UNO Charter School Network Inc. this month for defrauding bondholders is unlikely to slow that growth.

Charter schools nationally raised $1.3 billion in bond offerings last year, the most since they were first issued in 1998. Investors eager for higher yields are fueling the market, which is dominated by junk bonds.

UNO's problems are "typical of some charter schools, of growing pains and getting the management house in order," says Standard & Poor's Financial Services LLC analyst Carlotta Mills, whose agency gave that network a low investment grade rating with a "stable outlook."

The bond market for charter schools grew steadily in the decade leading up to 2007, with $1 billion raised that year, but the financial crisis halved offerings in 2008. Chicago charter schools have raised $215 million in the bond market since 1999.

Noble Network of Charter Schools, one of the city's fastest-growing charter systems, tapped the bond market for $20 million last year. Before that, UNO's troubled $37.5 million offering in 2011 was the most recent deal and that system's largest.

Local critics complain that charter schools aren't as transparent as traditional public schools, a criticism underscored by the UNO violation, in which a school executive handed $13 million in construction and window installation contracts to a relative.

The SEC action, its first bond case against a charter operator, required UNO to revamp its management and submit to monitoring to prevent conflicts of interest. UNO is "taking all necessary steps to move forward and continue providing quality public charter school education in Chicago," it said in a June 6 statement.

S&P justified its relatively rosy December rating on UNO—an update on an earlier rating—by pointing to the school's ability to win renewal of three charters, recovery from recent deficits, improved cash levels and waiting lists for its schools.

Since 2006, UNO has used about $60 million in bond financing to build 16 schools with about 7,500 elementary and high school students. In addition to UNO and Noble, Chicago International Charter School and Perspectives Charter Schools have issued bonds. Charters typically count on making future payments on the bonds with per-pupil funding they receive from the school board.

"The municipal bond market is clamoring for more charter school bonds, but the reality of the situation is that we would need a dramatic increase in facilities funding or large charitable donations to make new school buildings possible," says Craig Henderson, a founding board member at the Chicago International Charter School and an investment manager who specializes in tax-free muni bonds.

The Chicago charter schools have ratings just above investment grade, mainly because they are large networks with waiting lists of students. They also qualify as tax-exempt investments, thanks to the Illinois Finance Authority, which issues the bonds, although the state does not back them.

Finance Authority Chairman Bill Brandt says the UNO violation caused "consternation," but charter schools fit the agency's mission to foster education, employment and economic development. "As long as the school continues to have a significant amount of folks that want to go there and waiting lists and continues to perform financially as well as they have been, the bonds aren't implicated," Mr. Brandt says.

Investors are blowing off a slew of risks to earn higher interest rates. S&P rates 210 charter school bonds, with nearly half of them below investment grade, says Ms. Mills, who is based in San Francisco. And that's just a portion of the approximately 730 bonds ever issued because only half qualify for a rating.

Bondholder risks include schools failing to win renewal of their charters because of poor academic or financial performance, government cuts to education funding and inexperienced management. Defaults are more common than in municipal finance generally.

Still, the industry has a significant local presence. Milwaukee-based Robert W. Baird & Co., underwriter for UNO's troubled offering, is the second-biggest underwriter for charter school bonds across the country. Chicago-based B.C. Ziegler & Co. is the 10th-largest issuer. Chicago-based Nuveen Investments Inc., recently purchased by New York-based TIAA-CREF, is a major investor in charter school bonds.
With the industry feeding a Chicago charter school appetite to expand, there are likely to be more growing pains in the future.

By Lynne Marek June 23, 2014

S&P: Rating Methodology and Assumptions for Affordable Multifamily Housing Bonds.

Read the full report.

S&P: Why U.S. Availability Projects are Not Rated the Same as the Counterparty.

Read the Report.

S&P: Texas Unlimited Property Tax Infrastructure Districts Balance Debt Levels With Growth Needs.

Read the Report.

San Bernardino Targets $190,000 Firefighter Pay in Court.

San Bernardino, California, said that to exit bankruptcy it must terminate a union contract that pays an average annual salary of $190,000 to each of its top 40 firefighters.

In about three weeks, the city may try to use a federal bankruptcy law to cancel firefighter and police contracts if talks on new agreements fail, its lead bankruptcy attorney, Paul Glassman, told U.S. Bankruptcy Judge Meredith Jury at a hearing yesterday.

Since filing for bankruptcy in August 2012, the city has been mired in conflict with its unions and its biggest creditor, the California Public Employees' Retirement System, which it owes about $143 million, according to court papers.

The city told the judge yesterday that it has a final deal with Calpers. That leaves the unions as some of the last groups the city must win over, or beat in court, to put together a debt-adjustment plan that will return the community of about 200,000 to fiscal stability.

“We are different from every other creditor in the room,” David Goodrich, an attorney for the city firefighters union, said in court. He said San Bernardino is conspiring to close the fire department and contract out with another agency for the service. The city plans “to go after our pay and benefits and possibly the fire department itself,” he said.

Calpers Confidential

Glassman didn’t give details of the deal with Calpers, citing confidentiality rules imposed as part of mediation. The agreement will become public when the city brings it before Jury for approval.

City officials looked at the top 120 firefighters, its financial adviser Michael Busch told Jury. The average pay for the top 40 was $190,000 annually; the next 40 averaged $166,000 and the next 40, $130,000.

That scale is protected by a voter-approved city charter amendment that went through several years ago. The amendment limits how the city can negotiate union workers’ pay.

The city may ask voters to remove the amendment in November, Glassman said. Jury called that an “important” step in the bankruptcy.

The police force should know within three weeks whether it has a deal with the city, union attorney Ron Oliner said in court. The firefighters have already concluded that a deal isn’t possible and want to begin the battle over whether the city has the right to cancel the contract in bankruptcy court, Goodrich said.

San Bernardino, about 60 miles (97 kilometers) east of Los Angeles, was the third California city to file for bankruptcy in a three-month span in 2012. It cited a fiscal emergency brought on by a $46 million budget shortfall caused in part by the real estate crisis.

The case is In re San Bernardino, 12-bk-28006, U.S. Bankruptcy Court, Central District of California (Riverside).

By Steven Church Jun 19, 2014

To contact the reporter on this story: Steven Church in Wilmington, Delaware at schurch3@bloomberg.net

To contact the editors responsible for this story: Andrew Dunn at adunn8@bloomberg.net Joe Schneider

---

CDFA Excellence in Development Finance Awards.

2014 Call for Entries & Nominations

The CDFA Excellence in Development Finance Awards recognize outstanding development finance programs, agencies, leaders, projects and success stories. These awards, presented to award winners annually at the CDFA National Development Finance Summit, honor excellence in the use of financing tools for economic development, as well as the individuals who champion these efforts. Organizations may nominate themselves and/or their projects for one of these awards. Individuals may also nominate themselves or be nominated by their peers and colleagues.

The CDFA Excellence in Development Finance Awards cover a wide variety of financing tools and provide for both the public and private sector to be honored. Creative and innovative entries are highly welcomed, and the private sector is strongly encouraged to collaborate with their public sector partners on submissions. These awards honor excellence, leadership and the creative use of development finance tools such as bonds, TIF, tax credits and access to capital. The awards also honor the cutting edge use of development finance tools to support innovation and energy development. These awards honor individuals and agencies alike to build a distinguished and recognized development finance industry.

Entries and nominations for the CDFA Excellence in Development Finance Awards will be accepted through September 12, 2014. The following is an overview of the nine award opportunities (click on each entry to learn more):

- CDFA Lifetime Achievement Award
- CDFA Federal Development Finance Leadership Award
- CDFA Distinguished Development Finance Agency Award (State Agency)
- CDFA Distinguished Development Finance Agency Award (Local Agency)
- CDFA Excellence in Bond Finance Award
- CDFA Excellence in Tax Increment Finance Award
- CDFA Excellence in Tax Credit Finance Award
- CDFA Excellence in Energy Finance Award
- CDFA Excellence in Access to Capital Finance Award

Questions? Contact CDFA at etehan@cdfa.net

County Lawmakers Approve Compromise Deal Over Miami Dolphins Stadium.

MIAMI — Miami-Dade County lawmakers agreed on Tuesday to commit tax revenues to the Miami Dolphins football team if it can attract big-ticket events like the NFL’s Super Bowl and World Cup soccer matches to its privately owned stadium.

In return, the team agreed to self-finance a $350 million overhaul of its privately owned stadium.

The compromise deal came after the Florida Legislature rejected a previous proposal to use public funds to finance the stadium upgrade.

Local taxpayers soured on publicly financed stadium deals for privately owned sports teams after critics complained about the generous terms of a $500 million park for the Miami Marlins baseball team in 2008, funded largely by tax money.

Local officials recently rebuffed efforts by retired soccer superstar David Beckham to secure publicly owned waterfront land for a 20,000-seat stadium, even though Beckham agreed to finance it privately.

Since the recession, “people have found it a little distasteful for millionaire players and billionaire owners to get new facilities when police officers and firefighters are losing their jobs,” said Victor Matheson, a sports economist at the College of the Holy Cross in Massachusetts.

Under the deal Miami-Dade County commissioners approved on Tuesday by a 7-4 vote, the Dolphins can receive up to $5 million a year from county tourist taxes if they secure big sporting events, with payments starting in 2024.

The Dolphins hope to host World Cup matches in an upgraded stadium if Qatar is stripped of the 2022 tournament following allegations of corruption in the selection process.

Dolphins owner and billionaire real estate tycoon Stephen Ross said the $350 million overhaul of the nearly 30-year-old Sun Life Stadium, including a roof, more seating and a new Jumbotron, were needed to attract future Super Bowls.

Representatives for the team and the National Football League declined to comment.

Earlier this month, Miami-Dade County reached a deal with the Miami Heat to extend the team’s use of a publicly owned arena through 2035. The county raised its tax-funded subsidy by more than $2 million a year after the National Basketball Association team agreed to pay $1 million a year to the county’s parks department.

By REUTERS
JUNE 17, 2014, 6:12 P.M. E.D.T.

Municipal Issuer Brief - June 16, 2014

Read the Brief.

D.C. Water Considers First-Ever Century Bond by a Public Utility.

D.C. Water and Sewer Authority is contemplating being the nation’s first public utility to issue a bond that’s paid off over 100 years.

If Washington, D.C. is undertaking a project that will benefit – at minimum – the next three generations, then why make just one generation pay for it?

That question is the impetus for what would be a highly unusual move as D.C. Water and Sewer Authority contemplates offering a century bond this summer to help finance a major infrastructure project already underway. Century bonds, which are paid off over 100 years, are rare in the private sector and are mostly issued by colleges and universities. But it’s unheard of for a public utility to issue such a bond.

The tunnel project that DC Water is selling the bonds to help finance is a key reason why the utility is considering such a long-term bond in the first place. Thanks to innovative engineering and the fact that the tunnel will technically be empty of water most of the time, DC Water General Manager George Hawkins said it’s designed not to need significant maintenance for at least 100 years.

“This is by far the largest project we will undertake,” he said. “We want to match up the degree to which we are funding this project to its expected life. And we’re not saddling any one group of rate payers with this enormous cost. That’s sort of unfair because it’s … designed to last much longer.”

The $2.6 billion underground tunnel system will be 13 miles long and most of it will sit 10 stories underneath the District’s surface. Its diameter is equivalent to the size of a subway tunnel and its main purpose is to prevent flooding and runoff into the Anacostia and Potomac rivers during rainstorms. (Many of the city’s water pipes are more than 100 years old and some neighborhoods, particularly in the northeast section of the city, suffer from chronic flooding during flash rainstorms.) About one mile of the tunnel is finished at a cost of $250 million.

Hawkins said the utility is still weighing its options as it looks to sell a total of $400 million in bonds in late July. If it decides against a century bond (which would be taxable debt), DC Water will offer a 35-year tax-free bond, three-quarters of it at a fixed interest rate. If officials decide that the municipal market conditions, like the 100-year interest rate offered to DC Water, aren’t favorable then the utility will offer a traditional bond.

Although it’s unprecedented for a public utility to issue a century bond, analysts say there is likely still a strong market for such an offering. Higher education institutions have typically done well offering them – in 2012, the University of California system sold $860 million in taxable bonds, the largest century bond ever, after expanding its offering by more than $300 million because demand was so high.

“Investors are anxious to get exposure to municipal risk,” said Matt Fabian, an analyst for Municipal Market Advisors. “So a long maturity bond with limited call features [early repayment] ensures stability to an investor’s portfolio. They won’t have to worry about it maturing or being called away.”

Pension fund managers would especially be interested in such a long-life bond, said Sherman Swanson, managing director at Siebert Brandford Shank & Company. Because pension funds pay out retirement benefits and new employees are entering into the fund every year, a pension fund’s liabilities extend decades into the future.

“They’re trying to manage the assets they own to their liabilities,” Swanson said. “They need to get that longer in most cases.”

Liz Farmer |
lfarmer@governing.com | @LizFarmerTweets | Google+

Cook County Property Tax Bills to Have TIF Information.

The next set of Cook County property tax bills will show for the first time how much of each bill is going into controversial special taxing districts known as TIFs, county Clerk David Orr announced Thursday.

About 12 percent of county taxpayers own property that is in a tax increment financing district. Those districts are set up by the city and suburbs to divert money to economic development efforts. But critics contend many municipalities, including Chicago, have turned them into slush funds to pay for pet projects.

“The tax bills will be in the mail soon, but for the first time taxpayers will be able to see exactly how much of their money is going into the TIF fund," Orr said, referring to the second installment of property tax bills that will be due Aug. 1, about a month after they are mailed out.

Previous year's bills had a line item for TIF districts, but without the exact amount for each property. Instead, it referred taxpayers to a website that just showed the percentage of the bill that went to TIFs. From now on, the amount and percentage will be broken out on the bill, just as they are with each taxing agency.

In one example released Thursday, a TIF district centered around 43rd Street and South Cottage Grove Avenue will take a $1,739.42 bite out of one homeowner's property taxes, accounting for 85 percent of the bill. But those percentages can vary dramatically even between neighboring properties, because they depend on the values of those particular parcels at the time the TIF is established.

Orr's office also announced that Chicago homeowners can expect tax bill increases of .5 to 1.5 percent, although those increases could be higher or lower, depending on the individual property's assessed value and any changes in various exemptions afforded to homeowners and seniors.

"That will create individual fluctuations, which is why it's rather difficult to say every taxpayer is going to receive 'X' amount of increase or decrease," said Bill Vaselopulos, the clerk's director of real estate and tax services. "It's a case-by-case basis."

City bills are rising primarily because of increases enacted by Chicago Public Schools, the Chicago Park District and the Metropolitan Water Reclamation District, Vaselopulos said.

In the suburbs, tax increases could be as much as 2 percent, although those increases will vary from suburb to suburb and property owner to property owner, Vaselopulos said.

"There will be increases, but relatively small," in part because about a third of taxing districts were limited to maximum increases of 1.7 percent, or the rate of inflation, under Illinois tax cap laws, Vaselopulos said. The overall amount of taxes to be collected by all 1,500 taxing agencies is $12.1 billion, an increase of about 1 percent.

This year's increases are generally lower than in previous years, Vaselopulos said.

Orr has long worked to shed light on the amount of money collected by TIF districts. In those districts, any increases in property taxes that result from higher assessed values are paid into a special fund for up to 23 years. Money in those funds is then used to promote economic development, largely by paying for bricks-and-mortar improvements in the area.

The amount of total taxes to be paid by Chicago property owners this year is nearly $4.3 billion, according to data from Orr's office. The city expects about $375.9 million to flow into 151 TIF districts, according to the city budget. More than one in five city properties lies within a TIF district.

June 19, 2014|By Hal Dardick | Tribune reporter

hdardick@tribune.com

[Supply Doldrums End in Citigroup $330 Billion Call: Muni Credit.]()

The supply slump that's fueling the best run for municipal debt since 2009 is poised to end next year as governments ramp up borrowing for long-delayed projects from water to transportation, Citigroup Inc. predicts.

States and localities are set to borrow $330 billion in 2015, 18 percent more than this year, for the first increase in annual issuance since 2012, according to Citigroup. Governments will need to meet regulations for water and sewer systems and finance road and bridge upgrades, said George Friedlander, chief municipal strategist in New York at the third-biggest U.S. bank by assets.

An increase would be a welcome change for investors who are struggling to find bonds in 2014. Localities have sold $123 billion this year through June 13, the slowest pace since 2011, following a 15 percent drop in issuance last year, data compiled by Bloomberg show. Banks that handle the sales also stand to benefit should a renewed borrowing wave generate more underwriting fees.

"There's a lot of pent-up need for infrastructure," said Friedlander, whose bank was the third-biggest muni underwriter in 2013. "That's been true a long time, but some of it is reaching its maturation age where it needs to get done, water in particular."

Investment Lacking

The municipal market shrank the past three years as the 18-month recession that ended in 2009 led officials to curb spending and capital projects. There is work to be done: Municipalities need about $3.6 trillion of infrastructure investment by 2020, according to a 2013 report from the American Society of Civil Engineers.

The issuance drop has helped propel the $3.7 trillion market to a 6.1 percent gain this year through June 18, surpassing earnings of 2.6 percent for Treasuries and 5.2 percent for investment-grade corporate debt, according to Bank of America Merrill Lynch data.

With fewer sales, the cash available to purchase new borrowings often surpasses deal sizes, said Peter Hayes, head of municipal debt at New York-based BlackRock Inc., which oversees $108 billion of local securities. Investors are also less likely to sell their bonds, he said.

"Deals are so oversubscribed, not only from the traditional muni buyers but from the non-traditional buyers as well," Hayes said.

Vying Viewpoint

Janney Montgomery Scott LLC, meanwhile, sees the bond drought worsening.

Issuance will decrease every year to as low as $175 billion in 2017 as rising interest rates and an austerity push limit borrowing, Tom Kozlik, director of municipal credit analysis in Philadelphia, wrote in a report last month.

As the economy strengthens, yields on 10-year Treasuries, a benchmark for borrowing rates, will climb 0.72 percentage point to 3.35 percent a year from now, according to the median forecast of 73 analysts in a Bloomberg survey.

The years of $300 billion or more of total issuance "are likely in the past," Kozlik said.

Janney's 2017 call would mark a decline of about 60 percent from the peak level of 2010, the final year of the federally subsidized Build America Bonds program.

Function First

BlackRock doesn't expect issuance to sink as low as Janney predicts and estimates annual volumes will range from $275 billion to $325 billion, said Sean Carney, a muni strategist at BlackRock.

"That seems like the home for municipal issuance going forward," Carney said. "There's just a certain amount of issuance that needs to come each year to function."

Municipalities may borrow more as increasing revenue swells spending limits, Carney said.

U.S. states plan to raise expenditures in fiscal 2015 for the sixth straight year, although the projected 2.9 percent boost would be the slowest rate since 2010, according to a report from the National Association of State Budget Officers.

A pickup in state and local borrowing would also mean more business for underwriters.

The governments paid banks $523 million to handle $97.4 billion of long-term deals this year through May, based on an average cost of issuance of $5.37 per $1,000 of bonds, data compiled by Bloomberg show. That compares with $691 million on $127 billion of debt in the same period last year, based on an average cost of $5.46 per $1,000.

Needs Abound

In Citigroup's estimation, issuers will direct the additional bond proceeds to water and sewer systems, roads and hospitals.

Health-care systems may move forward with projects after assessing the fallout of the 2010 Patient Protection and Affordable Care Act, Friedlander said. Localities that have been waiting for Congress to replenish the U.S. Highway Trust Fund, which pays for transportation projects with gasoline and diesel-fuel taxes, will instead finance road and bridge upgrades on their own, he said. Lawmakers are working on an infusion into the fund, which is set to run out of cash in July, according to the U.S. Department of Transportation.

"The amount that's being funded now is a small portion of what needs to be in the highway, bridge and tunnel area, but it will get gradually higher," Friedlander said.

Utilities will need to update water systems and address environmental regulations, Friedlander said. Drought may also spur issuance, according to Philip Fischer, head of muni research in New York at Bank of America.

Drought covered about 37 percent of the contiguous 48 states, particularly California, Texas and Oklahoma, as of June 3, according to a report from the National Drought Mitigation Center at the University of Nebraska, Lincoln.

"There seems little double that the threats posed by droughts of this magnitude demand a large uptick in new water infrastructure investment," Fischer wrote in report this month.

By Michelle Kaske Jun 19, 2014 5:00 PM PT

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net
Mark Tannenbaum, Pete Young

[WSJ: Accounting Changes Proposed for State, City Retiree-Benefit Plans.]

States and cities could be forced to report at least half a trillion dollars of additional costs on their books under proposed rules that would shine a harsher light on the growing expense of retired workers' health insurance and other benefits.

The proposals, unveiled Monday by an accounting-standards group, would require state and local governments to add retiree-benefit promises to their balance sheets, making governments' overall financial position appear worse. In addition, many governments would have to change the way they calculate their benefit obligations in a way that could make their shortfalls appear bigger than they do now.

The move by the Governmental Accounting Standards Board is intended to give taxpayers, policy makers and investors more information about the toll that retirees' promised benefits will take on states' and cities' finances. The proposals wouldn't require governments to raise more money to pay for retiree benefits, and they wouldn't force governments to change the level of benefits they provide.

"It will provide a better picture of the cost and liabilities for these benefit promises," said GASB Chairman David Vaudt.

The proposals come as governments grapple with rising costs for current and retired workers. Some states have been racked by legislative battles over how to trim costs. Several municipalities, including Detroit and Stockton, Calif., have filed for bankruptcy protection in recent years amid retiree-benefit burdens, among other issues.

Some municipal-bond investors applauded the GASB proposal. The rule would show "how good a shape or how bad a shape the issuer is in," said Marilyn Cohen, president of Envision Capital Management, a Los Angeles fixed-income money manager.

According to a Standard & Poor's report last fall, California and New York are among the states with the highest level of unfunded retiree-benefit obligations. California, for instance, in March said it had $64.6 billion in unfunded health benefits for state retirees. A spokesman for the New York state comptroller's office said, "We are reviewing the proposals." A spokesman for the California state controller's office had no immediate comment.

The GASB proposals, which the board approved last month, are subject to public comment and possible reconsideration before the board adopts them. The board is accepting public comments through Aug. 29, and plans to hold public hearings on the proposals in September in New York, Illinois and California.

The proposals follow similar changes GASB made in 2012 to state and local governments' disclosure of pension obligations, which also were intended to give taxpayers and investors more information but would make pension funding appear weaker.

According to the Center for Retirement Research at Boston College, a group of 150 public-employee pensions that were 72%-funded in 2013, meaning their assets were 72% of their obligations, would have been only 65%-funded under the revamped rules.

The pension changes are only now fully taking effect, and Mr. Vaudt said it is too soon to tell what impact they will have in pressing state and local governments to address their pension underfunding.

Still, with the new retiree-benefit proposal, some investors believe the added visibility for benefit-plan underfunding could add to pressure on governments to address the problem. “This is a major step toward getting these funded,” said Matt Fabian, a managing director for Municipal Market Advisors, a Concord, Mass., research firm. “This is a problem that is as big as pension funding. Investors are clamoring for this.”

Moody’s Investors Service estimates states’ total unfunded retiree benefit liabilities at $530 billion, which would be added to governments’ balance sheets under the GASB proposals. Currently, the liabilities are reported only in the footnotes to government financial statements. The figure doesn’t include local governments’ benefit obligations, for which it is difficult to get an accurate total.

Another important change would revamp the way the obligations are valued. Most governments haven’t yet committed money to pay for their retiree benefits and work on a “pay as you go” basis. But to the extent that governments haven’t funded their benefits, they would have to measure the current value of those benefits using a lower interest-rate assumption. That has the effect of increasing the obligations’ current value and widening the plans’ funding shortfalls.

Marcia Van Wagner, a Moody’s analyst, is cautious about whether any changes in reporting retiree benefits will lead to more pressure on governments to fund their benefit plans. Governments have already been trying to trim benefits and reduce costs because of their overall financial problems, she said, not specifically because of any changes in accounting rules.

“I’m not sure that accounting standards really drive the policies of state and local governments,” she said.

Even Ms. Cohen questions whether the changes will help put more pressure on governments about funding their retiree benefits. “In theory, yes. In actuality, we’ll have to see.”

By MICHAEL RAPOPORT

Updated June 16, 2014 6:06 p.m. ET

Write to Michael Rapoport at michael.rapoport@wsj.com

Detroit Rolls Out New Model: A Hybrid Pension Plan.

In the face of Detroit’s tumultuous bankruptcy proceedings, in which multiple parties are quarreling to protect their interests, the city and its unions have quietly negotiated a scaled-back pension plan that could serve as a model for other troubled governments.

One of the most closely watched issues of the case is whether a government pension plan can be legally cut in bankruptcy. Detroit, saddled with a pension system it cannot afford, has introduced a new plan with the cooperation of its unions, which have been among the most vocal opponents of cutbacks.

While both retired and active workers now participate in the same city pension system, the new plan is intended only for Detroit’s active workers, who will shift to it on July 1. Retirees will keep 73 percent to 100 percent of their current base pensions under the city’s proposal to exit bankruptcy.

The new plan is called a hybrid, which means the workers will keep some of their current plan's most valuable features but will give up others. Trading down to a less generous pension plan is often said to be a legal nonstarter for government workers, so if Detroit succeeds, its hybrid could become a model for other distressed governments from Maine to California. Countless elected officials — from Rahm Emanuel, the Democratic mayor of Chicago, to Chris Christie, the Republican governor of New Jersey — are caught between ballooning pension obligations, angry local taxpayers who don't want to pay for them and labor lawyers who say it's impossible to cut back.

"We have a festering sore here," Christopher M. Klein, the judge in the bankruptcy case of Stockton, Calif., said at a hearing in May, referring to that city's surging pension costs. "We've got to get in there and excise it."

Detroit's current pension system simply costs too much relative to its battered tax base, and the watchword for Detroit this summer is feasibility. For the city to emerge from bankruptcy, its emergency manager, Kevyn D. Orr, must convince Steven W. Rhodes, the judge overseeing Detroit's bankruptcy case, that his long-term financial plan is feasible. The matter is to be decided at a trial to start in August.

There would be little hope of persuading Judge Rhodes if Detroit's workers were still covered by the existing pension plan and struggling local taxpayers were still liable for the relentlessly mounting obligations. For many years, the current plan allowed city workers to earn benefits that others in Detroit could only dream about — full pensions at 55, longevity bonuses, annual cost-of-living increases, an extra "13th check" in December and bankable sick leave that could be converted to cash, among others. In recent years, the resulting pensions have been greater than the per capita income of the residents who were expected to pay for them.

On June 30, Mr. Orr will freeze that pension plan, meaning that the city's current workers will not accrue any further benefits on those terms.

Starting the next day, in the new hybrid plan, they will still earn so-called defined-benefit pensions — a specified monthly payment based on tenure, age and earnings history — something their unions consider critical. But they will also start to bear most of the new plan's investment risk. That means Detroit's taxpayers — who pay a city income tax in addition to property and sales taxes — will no longer face cash calls every time the plan's investments drop in value. Officials hope that making the workers backstop the investments will discourage overreliance on high-risk strategies.

This unusual combination of features gives both the city and the unions an opportunity to declare victory and provides Mr. Orr with ammunition for the coming feasibility trial.

But it also flies in the face of a legal principle known as the vested-rights doctrine, which holds that the pension formula in force on the day a public worker goes on the job cannot be reduced for the full duration of employment. No such legal protection exists for workers in the private sector, whose pension plans can be frozen at any time. But in the public sector, the vested-rights doctrine is an article of faith, zealously defended, and it helps explain why a bankrupt city like Stockton is proposing to saddle its other creditors with big losses but not touch the pension plan.

The vested-rights doctrine is especially powerful in California, growing out of court decisions dating back to 1947. Unions in San Jose recently used it to keep the city from making its workers contribute more toward their pensions. Employees of four California counties argued in court last year that they had a vested right to pad their pensions by counting things like unused vacation time in their benefit calculations, despite laws prohibiting the practice. In March, Judge David B. Flinn of Contra Costa County Superior Court ruled that there was no such thing as a vested right to an illegal benefit — but the ruling applies only to current workers. Retirees are still receiving the padded pensions.

California's state pension system, Calpers, is a powerful proponent of the vested-rights doctrine, and many state and local governments follow its lead.

In Detroit's bankruptcy, however, the vested-rights doctrine does not appear to be an issue. The Michigan law for distressed cities gives emergency managers like Mr. Orr the power to set the terms of public employment. That means he can legally freeze Detroit's existing pension plans and establish new ones for city workers, said Bill Nowling, a spokesman for Mr. Orr.

"He is not making any benefit cuts," Mr. Nowling added.

For Detroit's retirees, it's a different matter. They are not being asked to give up benefits they had hoped to earn in the future; they are being told they must give up benefits they have already earned. Michigan's constitution forbids this, so Mr. Orr is using the Chapter 9 municipal bankruptcy process, in which federal law applies. A bitter battle is already taking shape.

By the time the fate of the retirees has been decided, Detroit's workers will already be earning hybrid benefits. To shift the investment risk their way, Detroit has set up a series of eight "levers" to pull if the plan's investments falter. They include setting up a reserve fund that must be used to cover losses, raising the workers' required contributions, lowering retirees' cost-of-living increases and making workers build up their benefits more slowly.

Should investments not produce the expected returns — in a protracted bear market, for example — leaving too little money to meet all obligations, officials will be required to pull as many levers as it takes to get the plan back to the 100 percent funded level within five years. Only if all eight levers are pulled and the plan is still not responding adequately can Detroit's taxpayers be called on to rescue it.

To measure the level of funding, the plan will assume a 6.75 percent rate of return. That still allows for a substantial amount of risk, although it is less than the 7.9 percent assumption the city was using when it declared bankruptcy. Officials of the American Federation of State, County and Municipal Employees, which led the negotiations, did not respond to calls seeking comment. The union is one of 48 that represent Detroit's municipal workers.

Even as they were negotiating the hybrid pension plan, Detroit's unions were still appealing a ruling last December by Judge Rhodes that pensions could be cut under federal bankruptcy law, despite protective language in Michigan's constitution. The unions are required to drop the appeal if they vote for Detroit's plan of adjustment. From California, Calpers has asked to serve as a "friend of the court" in the appeal, saying Judge Rhodes's decision "raises issues that are of critical importance to Calpers and its 1.7 million members."

Calpers's brief argues that Judge Rhodes ruled improperly and asks the United States Court of Appeals for the Sixth Circuit to vacate his finding that state laws protecting pensions are not binding in bankruptcy cases. Although California's laws have no force in a federal case in Michigan, Calpers expressed concern that rulings concerning Detroit's bankruptcy might recast the legal landscape in California.

"Such a precedent can be, and has been, misconstrued for the broad proposition that all pensions are subject to impairment in Chapter 9," the Calpers brief said.

By MARY WILLIAMS WALSH

The GASB'S OPEB Proposals are Now Available Online.

June 17, 2014

The GASB recently published two proposed Statements intended to significantly improve financial reporting by state and local governments of other postemployment benefits (OPEB), such as retiree health insurance. The GASB also published a third Exposure Draft that would establish requirements for pensions and pension plans that are outside the scope of the pension standards the GASB released in 2012.

The three proposals, which were approved on May 28, are available to download at no charge on the GASB website.

The first Exposure Draft related to OPEB, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB Employer Exposure Draft), proposes guidance for reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other employers.

The second Exposure Draft related to OPEB, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans (OPEB Plan Exposure Draft), addresses the reporting by the OPEB plans that administer those benefits.

The third Exposure Draft, Accounting and Financial Reporting for Pensions and Financial Reporting for Pension Plans That Are Not Administered through Trusts That Meet Specified Criteria, and Amendments to Certain Provisions of GASB Statements 67 and 68, would complete the pension standards by establishing requirements for those pensions and pension plans that are not administered through a trust meeting specified criteria.

To help users, preparers, and auditors of financial statements familiarize themselves with the proposals, the GASB developed an OPEB web page that features new "plain English" resources.

Muni Market 2014 Halftime Show.

The municipal bond market continued to roar ahead in the second quarter with long tax-free yields continuing their decline in April and May before rising slightly in June. Many of the same factors that were at work in the first quarter were again at work in the second quarter. Lower supply from a more austere universe of municipal issuers, higher demand from bond fund inflows, some asset allocation out of stocks and into bonds, and a general overall recognition of better municipal credit quality were all significant factors in the past three months. Liquidity – the ability to buy and sell bonds at reasonable spreads – has completely turned around from a year ago. Then we had the "taper tantrum" that saw record municipal bond fund outflows amidst fear of the Federal Reserve's scaling back bond purchases. That period of June and July 2013 was marked by the almost total nonexistence of what one would consider a market-level bid. This was, of course, on longer-maturity municipal bonds, which are what bond funds owned and had to sell to meet redemptions.

The graphs below demonstrate several salient points.

- Short-term yields were mostly unaffected last year, because the sell-off was the province of bond funds that bore the brunt of the tapering fears of retail investors
- Long-term bond yields were greatly affected, again because they were what bond funds WERE selling. The drop in trailing headline inflation from near 2% to 1.2% made longer-maturity tax-free munis the most compelling they had been since the post-Lehman Brothers sell-off of 2008.
- There has been a remarkable recovery in the tax-free bond market.

Municipal Bonds

As we look forward, we continue to grow somewhat more cautious. Although long high-grade municipal bonds continue to look attractive compared to long US Treasuries, the continued rally (drop) in nominal yields has us readying for a pause that refreshes. Our concern is that we have travelled a road where long intermediate- to high-grade paper went from 3.5% yields in early 2013 all the way to 5-5.25% in late summer and now back to the 4% level or below, in many cases. Though a case can be made for continued downward pressure in rates, we are starting to become somewhat defensive. Portfolios have self-shortened as bonds yield to shorter call dates; and, at the margin, we have raised 5-10% cash in accounts. Many issuers will be issuing bonds to refund older higher-coupon debt as we approach the end of this year. This trend will continue into 2016. Although the amount of "net "new issuance might not be that large, the new issues still have to clear the market. That bulge, along with a possible flare-up in rates due to wage inflation, could present a buying opportunity; and we would like to have the ammunition with which to seize it. In addition, many market participants point out the large reinvestment bulge coming on July 1st from coupon payments, maturing bonds, and called bonds. With longer yields down 100-125 basis points from their peak, that reinvestment scenario may be more muted than people think.

John Mousseau, CFA, Executive Vice President & Director of Fixed Income

By Cumberland Advisors (David Kotok) | Bonds | Jun 18, 2014 02:30PM GMT

N.J. Senior Home Offers Investors Unrated Debt: Muni Deal.

A retirement center in Voorhees, New Jersey, that's lost money for three years is selling unrated municipal bonds this week as returns on high-yield debt reach almost double the overall market.

SJF-CCRC Inc., an affiliate of the Jewish Federation of Southern New Jersey, runs Lions Gate, a continuing-care retirement community about 17 miles (27 kilometers) southeast of Philadelphia. Through the New Jersey Economic Development Authority, the nonprofit is offering $61.7 million in tax-exempt securities, principally to refinance debt on 152 apartments, 12 cottages, a 78-bed nursing facility, a 32-bed rehabilitation unit and a 70-bed assisted living center, according to bond documents.

Yields could go as high as 5.5 percent on the 30-year portion, said Andrew Nesi, executive vice president at the underwriter, Herbert J. Sims & Co. Inc., in Fairfield, Connecticut. That would be 2 percentage points higher than benchmark munis, data compiled by Bloomberg show.

“There are people who are looking for investments in this area,” Nesi said. “There’s not a lot of high-yield supply.”

High-yield debt is earning 9.9 percent this year, compared with 5.7 percent for the $3.7 trillion municipal market, S&P Dow Jones Indices show. High-yield funds have added cash for 23 straight weeks, Lipper US Fund Flows data show.

Yield-hungry investors would have to digest some risk. The Voorhees center has posted operating losses every year since 2011 and for the first three months of this year, deal documents show. Opening the rehabilitation facility last year drove expenses higher than revenue, as not all beds were filled all the time, said Douglas Hacker, Lions Gate’s chief financial officer.

Operating losses for such facilities are common for the first 10 years, Hacker said. Finances have stabilized for Lions Gate, which opened its first beds in 2006, he said.

“We have met our debt covenants,” Hacker said. “We’re a solid organization now and into the long-term future.”

The center is joining issuers offering $4.7 billion in bonds this week, down from $9.5 billion last week.

By Romy Varghese Jun 15, 2014 5:00 PM PT

To contact the reporter on this story: Romy Varghese in Philadelphia at rvarghese8@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Pete Young, Mark Tannenbaum

---