
Standard & Poor's Reclassifies 157 U.S. Public Universities; They are No Longer Government-Related Entities.

NEW YORK (Standard & Poor's) Dec. 5, 2014–Standard & Poor's Ratings Services has reviewed all rated entities in the U.S. public finance higher education sector it had previously classified as a government-related entity (GRE). Pursuant to our methodology, "Rating Government-Related Entities: Methodology And Assumptions," published Dec. 9, 2010, on RatingsDirect, GREs could receive extraordinary government intervention during periods of stress. We have reexamined the link between the government and the U.S. public universities we rate and have concluded the majority of these universities will not benefit from timely extraordinary government support, nor do we expect them to be subject to negative intervention by the related government, in that the state will not redirect funds away from it or take other action to impair the university.

As a result of this review, we will no longer apply the GRE criteria to 157 public universities in the following states: Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming. This also applies to public universities in the District of Columbia.

We do not expect this to have a significant impact on our ratings. The long-term rating on 155 institutions are unaffected by this change because the long-term rating and the stand-alone credit profiles (SACPs) on them are the same. However, as a result of this action, we have lowered the ratings on two public universities to the level of their SACP. We have downgraded Alabama State University to 'BBB+' from 'A-'; the outlook is negative. As well, we lowered the rating on the University of Northern Iowa to 'A' from 'A+'; the outlook is stable. These two institutions had previously benefited from a one-notch rating uplift for government support, as a result of the application of the GRE criteria. In conjunction with this review, we also raised the SACP on two universities. We raised our SACP on Iowa State University of Science and Technology to 'aa' from 'aa-' based on our assessment of strong enrollment growth, consistently strong operating performance, and financial resources that are consistent with the rating. In addition, we raised our SACP on the University of North Dakota to 'aa-' from 'a+' based on what we view as its strong demand profile, manageable debt, and financial resources that are comparable to those of other 'aa-' public universities. In both cases, the revised SACP equals the previous long-term rating. Therefore, although there is no longer a one-notch uplift from the SACP for government support, there is no change in the long-term rating.

We first applied GRE criteria to the sector in 2009. Since then, the Great Recession and the performance of U.S. states and public universities have informed our expectations that most public universities operate independently and do not benefit from timely extraordinary support. Universities in the U.S. have demonstrated a proven ability to withstand declining revenue sources, variability in endowment values, changing demographics, and various competitive pressures in a

range of economic cycles. Universities in the U.S. are autonomous entities. They have operated without any direct negative government intervention and retain full authority to implement any adjustments to respond to changing economic climates. These institutions operate separately from the state or federal government. U.S. states provide ongoing operating and capital support for public universities. However, we have seen that in times of fiscal stress, states have responded by cutting back ongoing operating and capital appropriations to these institutions. We have also seen that universities usually had full autonomy to raise tuition and other fees charged, as well as cut back on their operating expenses.

Although there is little history of public universities requiring extraordinary entity-specific support related to their fiscal stress, we also believe that U.S. states are less willing to provide this support. In most cases, there is also a lack of a government framework to predictably respond in a timely manner. This is because for most public universities, extraordinary support can only be given through the acceleration of funds annually appropriated. For some states, this can be done as an administrative action; others would require legislative action. In either case, the usefulness of the ability to accelerate already appropriated funds depends on the point in the year that the university would need liquidity, so the benefit is hard to predict. In addition, for most states, the requirement for legislative approval for any other support, in our view, affects both the predictability and the timeliness of support. We believe the same holds true for both Howard University and Gallaudet University, which receive annual appropriations from the federal government. The criteria focus on government intervention that enables timely repayment of a GRE's debt, reducing the likelihood of default.

We will continue to consider the remaining 14 public universities as GREs; for these, we either expect timely extraordinary government support or see a material risk of negative intervention from the related government. The GRE criteria apply to public universities in Hawaii, New York, Ohio, Tennessee, and the Commonwealth of Puerto Rico. No ratings are affected. We believe that Hawaii, New York, Ohio and Tennessee either have a legislative or administrative framework in place to provide timely extraordinary support.

For Hawaii, although there has been no need for extraordinary support, should an extraordinary event require state assistance, the director of finance and governor are statutorily authorized to provide temporary loans to the University of Hawaii (and other state departments and agencies) to meet their obligations. This does not require legislative action.

Similarly, New York considers both of its public universities to be state agencies. In addition, the state has an established history of helping distressed public entities and each year there is a substantial contingency appropriation that it could use with any other debt service appropriation. We consider these resources as sufficient to provide timely extraordinary support for either State University of New York or City University of New York, given that state appropriations already back most of the debt that each of these universities issues.

Ohio has a history of providing extraordinary support dating to the 1970s and as recent as the mid-1990s, including for debt service payments. Currently, state legislation requires that the state monitor the finances of the universities to ensure all payroll and debt service payments are made. Universities attest quarterly that they have made these payments. Officials use annual audited data to develop a score and place a university on fiscal watch. The state monitors debt to resources and operating surpluses as well as fund balances. This allows for timely extraordinary support for the universities in the state. The GRE criteria affect the nine public universities in Ohio.

In Tennessee, the Tennessee State School Bond Authority (TSSBA), a component unit of the state, issues debt for public universities. The TBSSA issues debt for revenue-supported projects for the

University of Tennessee (UT) board of trustees, which oversees the UT system (composed of four universities and three institutes), and the Tennessee board of regents, the governing body for six state universities, 13 community colleges, and 27 technology centers. The bonds benefit from a strong state appropriation-intercept mechanism, if fees and charges are insufficient to pay debt service. A statutory intercept of state revenues to the university secures the bonds. The state commissioner of finance and administration will, within one business day, intercept any operating and maintenance appropriations to the publicly funded institutions with projects under the resolution if the TSSBA notifies the commissioner that funds on hand are insufficient to pay debt service. We understand that the commissioner has never used the provision and the program has a 47-year history of no debt service shortfalls or defaults.

We continue to classify the University of Puerto Rico as a GRE. However, we have revised our view of the likelihood of extraordinary support to "low" from "high." The change does not affect the rating on the university because the rating does not include any uplift from government support. Our SACP on the university is the same as our rating on the Commonwealth of Puerto Rico (BB/Negative). The revision reflects our expectation, that given Puerto Rico's current fiscal condition, its ability to provide extraordinary support for the university is diminished. In addition, the university still relies on the Government Development Bank of Puerto Rico as its fiscal agent. We believe the liquidity pressures that face the commonwealth and GDB create the potential for negative intervention.

S&P: Renewables Start to Shape U.S. Utility Decisions; Stable Outlook for Utilities, but More Changes to Generation Portfolios are Expected.

Last week offered two announcements in the power industry that provide concrete evidence of the small toehold that distributed generation–especially photovoltaic solar–is starting to gain competitive ground in the future energy landscape of some electricity markets. First out of the gate, Germany's largest utility, E.ON, announced Dec. 1 a radical shift in its business strategy. The utility, which has one of the largest market capitalizations of major utility companies globally (currently about $37 billion) intends to divest about 51 gigawatts (GW) of conventional generation, spinning off these assets into a new, independent company. It will keep its renewable generation (about 4.4 GW), along with its distribution networks, and customer solution businesses. E.ON's CEO cited a few key reasons:

- Innovation in renewable energy and customer technology expectations has changed and mandates a change in how E.ON is organized to focus on opportunities.
- E.ON's existing structure can't adequately address the simultaneous challenges to conventional generation and tap into the renewable energy opportunities. The company characterized its existing conventional power plants that it will divest as a "safeguard security of supply for the transformation."
- Two companies are needed to address both the medium to near-term needs for central station generation, which E.ON expects could be increasingly supplanted by renewables over time.

Continue reading.

10-Dec-2014

Alaska, North Dakota, Wyoming Munis at Risk from Falling Oil.

Falling energy prices are benefiting some municipal bond sectors, like toll-road bonds and airport bonds. But states that lean heavily on the oil industry face growing financial risks as the price of oil keeps heading lower. Bank of America Merrill Lynch reports today that while 10 states account for nearly 78% of U.S. oil production, "the relative impact of declining prices differs widely" among these states. More from BofA strategists Philip Fischer, Yingchen Li, and Celena Chan:

"Alaska, North Dakota and Wyoming will feel the pinch much more acutely than states like Texas, California or Oklahoma, because tax revenues from oil production in the former states makes up disparately large proportions of total revenue collections. Texas has been through the ups and downs of crude prices and has, accordingly, developed a vibrant and diversified economy away from oil. Alaska is the most heavily reliant on oil revenues, where 78% of the states total revenues are attributed to oil. Each of these states, though, is a strongly rated credit."

BofA says the pain will extend to many local governments too:

"In some states, like North Dakota, large portions of the severance taxes that the state collects on oil are passed down to the local governments. Thus, local governments, which themselves budgeted for large remittances from the state, might face budget shortfalls. In states that do not pass down those revenues, local governments rely heavily on sales and use taxes. As oil production grew, so too did the labor force, which then participated in the local economy…. However, as production becomes less and less economical at lower and lower prices, producers may scale back production or altogether cease production…."

"As production is cut and new wells are left undrilled, jobs and individuals' discretionary income will likely fall in tandem. Local governments may be forced to find alternative sources of funds to pay for government services that were otherwise funded with revenues associated with that oil production. This will likely be felt in cities and counties where oil production is the dominant, if not only, industry. As these revenue streams begin to decline, issuers' often-competing responsibility between essential government services and debt service becomes that much more strained."

On the other hand, Puerto Rico – which is in desperate need of some good economic news – may see benefits to its public utility. BofA again:

"One beneficiary is Puerto Rico's Electric Power Authority (PREPA), which relies heavily on oil for its power generation. Seven out of 10 plants rely solely on oil, while an eighth plant uses a mix of oil and natural gas. Oil-produced energy accounts for 70% of PREPA's costs."

Barron's

December 12, 2014, 3:50 P.M. ET

By Michael Aneiro

Why Muni-Bond Investors are Wondering what Illinois is Going to Do.

Municipal debt investors are watching the appeals process that will decide whether or not Illinois' pension reform bill ends up in the wastebasket, a decision that would send the Land of Lincoln back to square one in its attempts to battle its pension funding crisis.

“There’s so much uncertainty there,” Daniel Solender, the lead portfolio manager for municipal bonds at investment manager Lord Abbett & Co., said by phone Wednesday. “It’s hard to know what the right valuation is [for the state’s bonds].”

So far, investors are waiting and watching. Solender noted that there hasn’t been much trading in Illinois’ bonds in response to a Nov. 21 Circuit Court decision that said the reform bill was unconstitutional. If the Illinois Supreme Court upholds that decision, Solender expects a negative effect on the state’s bond values.

“For investors to get comfortable, there has to be some idea of a plan [for pension reform], and there doesn’t seem to be one [now],” he said.

Still, he is confident that Illinois has time to work out its pension issues one way or another.

Solender and other sources are looking optimistically to Governor-elect Bruce Rauner, a Republican, to address the issue. Rauner will replace Pat Quinn, a Democrat, on Jan. 12.

Illinois’ unfunded pension liability has ballooned to $111.2 billion, according to a November report by the Illinois Commission on Government Forecasting and Accountability. The Teachers’ Retirement System accounts for about half of that at $61.6 billion, the report said.

A June 24 report by Standard & Poor’s revealed that Illinois has, by far, the lowest level of pension funding in the country at 40.4% funded, followed by Connecticut (49.1%).

As part of a Dec. 1 panel in New York City that discussed municipal debt restructuring, William A. Brandt Jr., president and CEO of Development Specialists Inc., said that Illinois holds 43% of the public pensions in the U.S. According to Brandt, who is also the chair of the Illinois Finance Authority, those amount to some 652 public pensions.

“Illinois is your problem state,” he warned.

The pension reform bill, which was approved in December 2013 with the support of Quinn, aimed to address the pension funding gap by raising minimum retirement ages, lowering cost-of-living adjustments, and putting a cap on the base salary that serves to determine pension payments.

However, Judge John W. Belz of the Circuit Court for the Seventh Judicial Circuit in Sangamon County, Ill., ruled on Nov. 21 that the bill violated the state constitution.

The plaintiffs in the case had argued that the bill violated the Pension Protection Clause in the Illinois state constitution, which prohibits impairing or diminishing pensions. The defendants countered that Illinois could enact the pension reform bill using the sovereign powers or police powers granted to U.S. states.

Belz ruled in the plaintiffs’ favor, concluding, “The Illinois legislature could not have been more clear that any attempt to diminish or impair pension rights is unconstitutional.”

According to Michael Comes, a portfolio manager and vice president of research at Cumberland Advisors Inc., the most palatable pension reforms are ones that affect brand-new city employees. Pension reforms that have been popular among other states recently include raising the retirement age, changing the formula for cost-of-living increases, raising employee contributions to their pensions, or switching employees over to 401(k) plans, Comes said by phone.

Moody’s Investors Service Inc. expressed skepticism that the state Supreme Court would reverse the

circuit court ruling.

“While a lower-court ruling can, of course, be reversed, this summer the Illinois Supreme Court indicated in a separate case on retiree health benefits that it will adhere strictly to the pension protection clause, a legal barrier that for many years has impeded political consensus on reforms affecting current Illinois pension participants,” the ratings agency said in a Nov. 24 report.

Illinois’ credit rating of A3 is the lowest among U.S. states, five notches below the median, Moody’s said.

The ratings agency added that Illinois’ ratio of adjusted net pension liability to revenue was 268% in 2013, well above the 60% median for all states.

In a Nov. 11 report, Moody’s Analytics referred to Illinois as “the country’s most financially troubled state.”

S&P singled out Illinois alongside Kentucky, New Jersey, and Pennsylvania as states with credit quality harmed by pension funding issues.

According to an April 8 report by the Pew Charitable Trust, state-run retirement systems had a shortfall of $915 billion during fiscal 2012, a number that ballooned to more than $1 trillion when local government obligations were considered, as well. That number is up from $452 billion in fiscal 2008.

If the state of Illinois and its municipalities struggle under their load of obligations, they won’t have access to municipal bankruptcy protection. States are prohibited from filing for Chapter 9 under the federal bankruptcy code, and Illinois doesn’t have a mechanism that would allow its municipalities to file under that section.

Brandt noted that major Chapter 9 filings such as those of the City of Detroit, Mich., and Jefferson County, Ala., aren’t your “customary” bankruptcy filings — they are “event-driven.”

He notes that for some struggling municipalities, they are “corporate entities that may or may not need to exist any more.”

The Street

By Lisa Allen | 12/11/14 – 09:25 AM EST|

— Kelsey Butler contributed to this report

Oil Dive Propels Toll-Road Bonds to Biggest Rally: Muni Credit.

Bonds for tollways are en route to beating the municipal market by the most in nine years as cheaper oil and a growing economy lead more Americans to hit the road.

Debt backed by toll and turnpike revenue has earned 12.1 percent this year, compared with 9.5 percent for all munis, Bank of America Merrill Lynch data show. The outperformance is the most since the data began in 2005 as investors bet that Americans will drive more as the price of oil plunges to the lowest level since 2009.

About 46.3 million people in the U.S. were set to travel more than 49 miles (79 kilometers) during the Thanksgiving holiday period, the most since 2007, according to a projection from AAA. The trend signals a buying opportunity in toll bonds, which offer above-average yields as municipal interest rates remain close to generational lows, according to American Century Investments and Morgan Stanley.

“The toll-road sector is currently attractive and should do well as gas prices stay low and there’s more driving, while the overall economy remains strong,” said Steven Permut, who oversees $6.5 billion as head of munis at American Century in Mountain View, California.

Avoiding Congestion

Traffic will grow as much as 2 percent next year on average for tollways rated by Moody’s Investors Service, while revenue will jump 5 percent, the company said in a report last month. As free roads get busier, tolled routes may lure drivers, according to Moody’s, which gives the segment a stable outlook.

Investors should buy more transportation-revenue bonds than benchmarks suggest, according to Michael Zezas, head of muni research at Morgan Stanley. He recommends putting more cash into tollway and airport debt than into any of the other parts of the market listed in a Dec. 8 report.

Crude-oil futures on the New York Mercantile Exchange have plummeted as the U.S. shale boom boosts production while growth in global demand slows. The price fell below $62 per barrel today, the lowest since July 2009.

Average retail gasoline prices have slumped to a four-year low of about $2.64 a gallon, according to AAA. An Oklahoma City station sold gasoline for $1.99 a gallon Dec. 3, becoming the first in the U.S. to drop below $2 since July 2010, according to GasBuddy.

Biggest Borrowers

Municipal issuers have $118 billion of debt tied to toll roads, bridges and tunnels, data compiled by Bloomberg show. The biggest borrowers are the New Jersey State Turnpike Authority, the Bay Area Toll Authority, which runs the San Francisco-Oakland Bay Bridge, and the North Texas Tollway Authority.

The Texas agency issued $457 million of debt Nov. 5. Bonds rated A2 by Moody’s, the sixth-highest level, and maturing in January 2025 priced to yield 2.89 percent, Bloomberg data show. That was more than the 2.66 percent yield on an index of munis with a similar grade and maturity.

Last week, the Pennsylvania Turnpike Commission issued $294 million of revenue bonds rated A1 by Moody’s, one level higher than the Texas debt. Securities due in December 2024 priced to yield 2.71 percent, compared with about 2.6 percent on an index of similarly-ranked revenue bonds.

Yield Lure

The extra yield means that toll bonds have room to extend the rally, said Dan Solender at Lord Abbett & Co.

“Some of the transportation-type sectors seem to have a little more spread and room to tighten,” said Solender, who oversees $16 billion as director of munis for Lord Abbett in Jersey City, New Jersey.

The outlook for travel next year may be even better as people adjust to cheaper prices, said Michael Green, a spokesman for Heathrow, Florida-based AAA.

“If gas prices remain less expensive well into 2015, we could see people change their driving habits as a result,” said Green, who’s based in Washington.

Less costly gasoline may benefit most of the $3.7 trillion municipal market by increasing discretionary income and tax revenue, said Chad Farrington, head of muni research in Boston at Columbia Management Investment Advisers, which oversees about $30 billion in local debt.

Pinched Parties

Yet energy-producing states may be pinched as tax revenue tied to energy declines, he said. North Dakota, with the lowest unemployment rate nationwide at 2.8 percent, may see its production boom falter if current oil levels persist, Farrington said.

Moody’s in October also cited Texas, Alaska, Oklahoma and New Mexico as states where collections are at risk. Louisiana froze spending last month to prepare for reduced oil revenue.

The decline may be offset in some states by increased hiring, with the U.S. jobless rate at a six-year low of 5.8 percent.

“The domestic economy remains solid and that along with lower oil prices will be very beneficial to the transportation sector,” said Permut at American Century. “We’re going to continue to see strength there.”

Bloomberg MuniCredit

By Brian Chappatta and Elizabeth Campbell

Dec 10, 2014 7:29 AM 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: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Pete Young

---

Muni Sales Poised to Decelerate While Redemptions Rise.

Municipal bond sales in the U.S. are set to decrease in the next month while the amount of redemptions and maturing debt rises.

States and localities plan to sell $14.6 billion of bonds over the next 30 days, according to data compiled by Bloomberg. A week ago, the calendar showed $20.8 billion planned for the coming month. Supply figures exclude derivatives and variable-rate debt. Some municipalities set their deals less than a month before borrowing.

In the coming weeks, Los Angeles Community College District plans to sell $1.33 billion of bonds, Dallas has scheduled $529 million, the Bay Area Toll Authority in California will offer $536 million and Harris County/Houston Sports Authority will bring $458 million to market.

Municipalities have announced $15.2 billion of redemptions and an additional $12.7 billion of debt matures in the next 30 days, compared with the $27.5 billion total that was scheduled a week ago.

Issuers from Illinois have the most debt coming due with $2.55 billion, followed by New Jersey at $1.33 billion and New York with $1.13 billion. The state of Illinois has the biggest amount of securities maturing, with $952 million.

The $3.5 trillion municipal market contracted by $641 million last month. Sales of $34.8 billion compared with redemptions and maturing debt that totaled $35.5 billion.

Bloomberg News

By Ken Kohn Dec 8, 2014 4:16 AM PT

To contact the reporter on this story: Ken Kohn in New York at kkohn@bloomberg.net

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

---

Standard & Poor's: Diverging Trends Keep U.S. States' OPEB Liabilities Relatively Stable.

From Standard & Poor's CreditMatters TV:

Diverging Trends Keep U.S. States' OPEB Liabilities Relatively Stable.

SIFMA Survey: Total Muni Issuance to Edge up 2.7% to $357.5B in 2015.

WASHINGTON – Total tax-exempt and taxable municipal bond issuance in 2015 is expected to edge up to $357.5 billion, an increase of more than 2.7% from the $348.1 billion forecast for this year, according to respondents of an industry survey.

The 2015 estimated level would be a 17.3% drop from peak muni issuance, which was $433 billion in 2010, according to Thomson Reuters data.

Issuance would rise slightly to $315.0 billion from $305.3 billion this year for long-term munis, while it would remain almost unchanged at $42.5 billion from 42.8 billion for short-term munis, according to median estimates from the 14 bank and broker-dealers firms that responded to the Securities Industry and Financial Markets Association's annual survey. They made their projections between Nov. 7 and Nov. 21.

Issuance of long-term tax-exempt munis not subject to the alternative minimum tax is expected to be up only slightly in 2015 to $275 billion from $273.5 billion this year, according to survey respondents.

"I think of that as essentially flat issuance for next year," said Michael Decker, a managing director of SIFMA and co-head of its muni division. "Bank lending is continuing to draw from public issuance. Many issuers are able to get very attractive terms from banks for short- and medium-term

borrowings. That's a driving factor of continued weak issuance."

Bank borrowings include both loans and private placements, he said.

In addition, state and local governments are still not borrowing to the extent they were prior to the Great Recession, Decker said.

The survey respondents estimated bank lending would fall to an estimated $35 billion, or 9.8% of issuance of long-term munis, from $45 billion this year.

But Decker stressed that these are just estimates. "We don't really know what the total of bank lending is," he said. "I'm not aware of a good data source."

Refundings are projected to remain mostly unchanged in 2015 at 45% of issuance of long-term munis, compared to 46% this year.

But survey respondents projected the issuance of taxable munis and munis subject to the AMT to rise. They estimated 2015 issuance of taxables will increase to $30 billion, a 29.3% increase over this year, and that issuance of AMT munis would rise to $10.0 billion, a 16.7% gain.

They also projected issuance of variable rate demand obligations to increase to $9.0 billion in 2015, from a record low of $6.6 billion in 2014.

Decker said the survey found that, "from a credit perspective, the market is sound."

"We're not going to see any systemic credit issue in 2015, but we may see some isolated credit events," he said, explaining when asked that these could range from technical defaults to distressed financials for issuers, or even bankruptcy filings.

Asked what could have the greatest impact on the muni market in 2015, most respondents put curtailment of tax exemption for munis at the top of the list.

President Obama, in his budget requests, has proposed capping the value of tax exemption to 28%. The tax reform draft offered by House Ways and Means Committee chairman Dave Camp, R. Mich., which could form the basis for future plans, proposed what would amount to a 25% cap on the value of tax-exemption, as well as the elimination of tax exemption for private-activity bonds issued after 2014.

Survey respondents were also concerned about the underfunded pensions of many state and local governments, as well as general economic weakness and the tendency of some issuers to defer maintenance or improvements of capital projects.

THE BOND BUYER

BY LYNN HUME

DEC 4, 2014 12:00am ET

MassDirect Notes Win Deal of the Year.

Modeled in part on the U.S. Treasury's TreasuryDirect, the innovative new program makes highly-

rated Massachusetts general obligation bonds available to retail investors on a nearly continuous basis through a retail rolling offering. In 2014, Massachusetts sold on average more than $6 million a day and sold out the full $250 million program one month ahead of schedule.

The MassDirect program is “a window into the future of the municipal bond market,” said Michael Scarchilli, editor in chief of The Bond Buyer, when presenting the award at a ceremony held at the Waldorf Astoria hotel in New York City. “It democratizes primary market distribution for retail investors and takes a critical step toward pre-price transparency.”

The deal also won the Deal of the Year award for Non-Traditional Financing, marking the first time that category, which debuted in 2006, has yielded an overall winner. It’s the second Deal of the Year win for the Commonwealth of Massachusetts, however, as its billion-dollar Accelerated Bridge Program bond package won the national honors from the Northeast position in 2011.

MassDirect bonds are sold by the state’s underwriter, Citi, through TMC Bonds, an open architecture electronic trading platform which already carries over 30% of all interdealer secondary trades in the muni market. And now, Massachusetts new-issue bonds reach hundreds of independent brokers and thousands of retail investors who never had access to new-issue bonds in the past.

For the fourth year, the Deal of the Year gala included the presentation of the Freda Johnson Award for Trailblazing Women in Public Finance. This year, the organization honored two public finance professionals; one from the public sector and one from the private. The 2014 honorees were Chicago’s Chief Financial Officer Lois Scott, and veteran New York-based banker Kym Arnone, the Municipal Securities Rulemaking Board Chair.

The night also featured a video tribute to muni market legend Jim Lebenthal, who passed away in November. His daughter Alexandra Lebenthal followed the tribute with a rousing speech for which she received a standing ovation.

For more than a decade, the editors of The Bond Buyer have selected outstanding municipal bond transactions for special recognition. The 2014 awards, which considered deals that closed between Oct. 1, 2013 and Sept. 30, 2014, drew nominations that represent the full diversity of the communities and public purposes that are served by the municipal finance market.

Issuers were honored in eight categories, revealed online Nov. 3-7 through separate video announcements at BondBuyer.com.

The other finalists were:

Northeast Region

The $350 million century-bond offering from the District of Columbia Water & Sewer Authority, which may set a precedent for municipalities across the nation with pressing long-term environmental infrastructure needs. DC Water’s innovative deal not only helps meet national water quality standards, it marks the first sale of a century bond by a water and sewer utility and the first independently certified green bond sold in the United States.

Southwest Region

The Colorado Regional Transportation District’s $441 million offering of certificates of participation, which marked the first time that any issuer had used a proposed rail line as the leased property in a COP deal. The transaction was the second largest tax-exempt issuance of COPs in the past five years and the largest issuance in the transportation sector in the past decade.

Midwest Region

The Karegnondi Water Authority's $220.5 million financing to fund a 63-mile pipeline to Lake Huron, which completed Michigan's Flint and Genesee County's breakaway from their dependence on the Detroit water system. Entering a market where local governments across Michigan have faced heightened penalties, the authority sold the bonds to more than 30 investors and achieved an all-in borrowing cost below projections.

Southeast Region

The Louisiana State Bond Commission's $112 million financing of unclaimed property special revenue bonds, on behalf of the State of Louisiana, which needed to finance a portion of the state's 200-mile-long Interstate 49 project. The state solved the problem with a unique and unconventional approach: securitizing unclaimed property receipts. To strengthen the credit, the state added an appropriation-backed promise to replenish the debt service reserve.

Far West Region

The County of Los Angeles Redevelopment Refunding Authority's $53 million refunding of tax allocation bonds, removing them from a post-California redevelopment agency dissolution limbo. The offering was the first to be issued through a countywide program that enables its public finance staff to put together refundings for cities in the county, and the first to use a pooled structure that combined individual successor agencies into a single refunding series.

Healthcare Financing

The $1.04 billion Health and Educational Facilities Authority of the State of Missouri revenue bond transaction, which financed a complex debt restructuring and management structure reevaluation for St. Louis-based SSM Health Care. The transaction decreased the weighted average cost of debt for SSM Health to 3.1% from 4.6% and lowered the maximum annual debt service by nearly 10 percent, resulting in a savings of about $3 million per year.

Small Issuer Financing

The Village of Oakwood in Cuyahoga County, Ohio's $2.69 million of various purpose notes, the first transaction financed through the Ohio Market Access Program. The unique credit enhancement program created by the Ohio Treasurer's office helped Oakwood carry top short-term credit marks, expanded its universe of buyers and lowered the village's borrowing cost by about 50%. The program offers a model that can be replicated nationwide.

THE BOND BUYER

DEC 4, 2014 9:00pm ET

Firefighters Lose Bid to Sue Bankrupt San Bernardino in State Court.

Calif Dec 3 (Reuters) – Firefighters in bankrupt San Bernardino cannot sue the city in a California state court over lost wages and benefits, the U.S. Bankruptcy Court judge overseeing the case ruled on Wednesday.

“Starting to allow parties to argue their claims in another forum isn’t a precedent I want to set,” U.S. Bankruptcy Judge Meredith Jury said.

The city’s firefighters union had sought to escape the automatic block on suing a city under Chapter 9 bankruptcy protection. Firefighters want a state court, not the federal bankruptcy court, to hear their arguments that the city has illegally cut wages and benefits since declaring bankruptcy in August 2012.

Jury said she would not approve any city bankruptcy plan that breaks state law when it comes to firefighter compensation.

San Bernardino, a city of 205,000 people 65 miles east of Los Angeles, filed for bankruptcy in August 2012 with a budget deficit of $45 million.

The city is one of a handful of municipal bankruptcies, including Detroit, Michigan and Stockton, California, being closely watched by the $3.7 trillion U.S. municipal bond market. Bondholders, public employees and other state and local governments are keen to understand how financially distressed cities under Chapter 9 protection handle debts to Wall Street, large pension funds and other creditors.

Last month, San Bernardino revealed it was not going to challenge its largest creditor, the California Public Employees’ Retirement System (Calpers), in any bankruptcy plan.

In a deal struck during private mediation sessions with Calpers over the past year, San Bernardino has agreed not to reduce future payments to the giant fund, America’s biggest public pension system with assets of $300 billion. The city has also begun repaying about $13 million in arrears to the fund.

That leaves open the prospect of the city cutting what it owes to other creditors, including Wall Street bondholders and insurers.

These include Ambac Assurance Corp, insurer of $50 million of pension obligation bonds issued to the city in 2005, Erste Europäische Pfandbrief-und Kommunalkreditbank AG, holder of the bonds, and Wells Fargo Bank, the bond trustee and the flagship bank of Wells Fargo & Co.

BY TIM REID

RIVERSIDE Wed Dec 3, 2014 6:40pm EST

(Reporting by Tim Reid; Editing by David Gregorio)

Municipal Rush to Borrow May Repeat: Chart of the Day.

The biggest calendar of proposed municipal-bond offerings in more than five years may be more than a one-time event, according to John Mousseau, Cumberland Advisors Inc.’s director of fixed income.

As the CHART OF THE DAY illustrates, state and local governments planned as of yesterday to raise $18.7 billion through debt sales in the next 30 days, according to data compiled by the Bond Buyer. The previous day’s $19.1 billion total was the highest since June 2009 and more than double this year’s average of $7.9 billion.

Much of the borrowing will be done to refinance bonds that were sold a decade ago, when yields were higher, Mousseau wrote three days ago in a post on Cumberland's website. The average yield on 20-year municipal securities was 3.54 percent last week, down from 4.60 percent at the end of November 2005, according to Moody's Investors Service.

Similar surges in sales may happen during the next two years, especially "at the junctures of large maturities of bonds — that is, January and July," the Sarasota, Florida-based investor wrote. "This is a tried-and-true method for issuers to manage and lower their overall debt-service costs."

The current increase in what the Bond Buyer calls 30-day visible supply may send municipals lower, Mousseau wrote. As he put it: "The sheer size of the calendar should allow for some softening of prices."

Longer-term municipals may be available for purchase at yields 35 percent to 40 percent more than those on comparable Treasury securities, according to Mousseau, an executive vice president whose firm manages $2.2 billion of assets.

BLOOMBERG NEWS

By David Wilson Dec 4, 2014 10:19 AM PT

To contact the reporter on this story: David Wilson in New York at dwilson@bloomberg.net

To contact the editors responsible for this story: Chris Nagi at chrisnagi@bloomberg.net

---

U.S. Municipal Bond Issuance to Flatline in 2015 - SIFMA.

Dec 4 (Reuters) – New borrowing by U.S. states, cities and other parts of the public sector will nearly flatline next year, with issuance of tax-exempt debt likely rising to $275 billion from around $273.5 billion this year, according to a trade group's survey released on Thursday.

The growing practice of issuers borrowing directly from banks, instead of tapping the $3.7 trillion municipal bond market, will contribute to the stasis, the Securities Industry and Financial Markets Association (SIFMA) found in its annual survey.

Over the last few years the public sector has looked more to bank loans, which have less oversight and fewer disclosure requirements, for financing needs.

"We expect municipal issuance to remain mostly flat to up slightly in 2015, with bank lending continuing to provide borrowers with an alternative to public bond issuance," said Michael Decker, one of the heads of SIFMA's municipal securities group, in a statement. "Short- and long-term yields will likely creep up, in part as a response to changing monetary policy."

Still, the survey of banks and underwriters found direct placements of bonds to banks could drop to $35 billion in 2015 from $45 billion this year.

Total issuance, which includes taxable debt, will reach $357.5 billion in 2015, up from $348.1 billion estimated this year, SIFMA said.

Any rise will come from long-term debt. In 2015, SIFMA expects $315 billion in long-term bonds, compared to $305.3 billion in 2014.

Debt sales this year are catching up to last year's levels after plunging at the beginning of 2014. Rising interest rates dried up refinancing at the end of 2013 and beginning of 2014. By July this year, issuance was running 15.4 percent below 2013, exclusively due to a drop in refundings, Thomson Reuters data showed.

Then interest rates dropped, and as of November sales were just 3.3 percent less than last year.

On Municipal Market Data's benchmark scale, the yield on a top-rated 10-year bond on the first trading day of this year was 2.79 percent and on a highly rated 30-year was 4.20 percent. As of Wednesday, the yield on the 10-year bond was 2.08 percent and on the 30-year 3.02 percent, according to MMD, a Thomson Reuters company.

Nonetheless, SIFMA said 2015 will see the same level of refundings as this year.

WASHINGTON Thu Dec 4, 2014 11:32am EST

(Reporting By Lisa Lambert; Editing by Meredith Mazzilli)

Municipal Issuer Brief - Pros/Cons for Upcoming Deal Slate.

Download the Brief.

Municipal Market Advisors | Dec. 2

Fitch: Ratings Reflect Issuers' Resiliency to Hazardous Events.

NEW YORK–(BUSINESS WIRE)–Fitch's ratings incorporate an assessment of an entity's credit characteristics which speak to overall resiliency to manage unexpected events, according to a Fitch Ratings report.

Under a disaster scenario, those issuers which possess revenue diversity as well as an ample supply of reserves and liquid assets are afforded the ability to quickly restore operating capabilities, as well as finance the clean-up and recovery effort, until private insurance and state and/or federal disaster reimbursement funds are received, according to Fitch's report.

Issuers with small geographies, limited liquid financial resources or limited assets, such as some higher education institutions or health care facilities and utilities, may be more vulnerable to credit deterioration following an event.

The diversity of state revenues and large geographic service areas position state ratings favorably with regard to event risk. Fitch does not see event risk rise to the level of a key rating driver in any of its state general obligation ratings. Similar to states, most local government issuers demonstrate a level of revenue and geographic diversity that limits Fitch's concerns regarding the impact to bondholders from event risk.

Event risk for electric utilities is a limited concern, primarily for utilities with very small service areas in regions prone to natural disasters or those with single generation asset risk. As a result of the essentiality of the service provided, electric utilities have emergency response plans in place and

perform periodic drills to test the plans and response times as a standard industry practice.

Water utilities are less likely than electric utilities to experience single event weather-related destruction of their distribution pipelines, given their underground nature. The damage to underground pipelines has more to do with aging infrastructure and the lack of routine repair and replacement programs.

Healthcare issuers are also typically not prone to hazard risk but there are limited cases where the issue rises to a level of credit consideration in Fitch's ratings. Healthcare issuers can be more vulnerable to event risk in instances where there are significant levels of single asset risk and concentrated revenues.

Higher education obligors can be vulnerable to event risk due to their concentrated asset base and high level of tuition dependence. The likely frequency of recurrence of any natural event may be tied to its location, making them more vulnerable to such events.

Housing agencies across the 50 states have built up large reserves over their 30 to 40 year history and therefore are capable of handling many unknown risks. Mortgage insurance, property insurance and Federal Emergency Management Agency for flood insurance and catastrophic losses tend to make this sector rather stable.

For more information, a special report titled 'Event Risk and Overall Credit Resiliency' is available on the Fitch Ratings web site at www.fitchratings.com.

December 02, 2014 05:15 PM Eastern Standard Time

Moody's: Outlooks for US States and Local Governments Remain Stable on Stronger Revenues.

The 2015 outlooks for states and local governments are stable as a strengthening US economy supports state revenue growth and property tax revenues slowly recover, supporting the local governments. State tax revenue growth in 2015 will rise faster than in 2014, but remain within a 5% – 6% range, moderate by historical standards for the sector, while property taxes will grow at 2%-3% for the next several years…

Purchase the Report.

WSJ: Most States are Good Credit Risks.

Even when hefty pension obligations and unfunded employee health-care liabilities are taken into account, state credit quality generally is strong.

The $518 billion of state general-obligation bonds and other state-supported debt are probably the best slice of the $3.7 trillion municipal-bond market. General-obligation bonds are backed by states' full faith and credit.

This table shows the yield premium, measured in hundredths of a percentage point, of 10-year state

general-obligation debt above a triple-A benchmark, now about 2.15%. (Ratings for some states are more indicative than real, because they have little or no debt outstanding.)

Barron's has looked at state financial health for the past three years using data compiled by Eaton Vance. This year's tally differs from last year's because it offers a more comprehensive picture, based on about 10 measures that factor in assets, liabilities and other gauges of economic health.

THE WALL STREET JOURNAL
By ANDREW BARY
Nov. 29, 2014 8:11 p.m. ET

Houston Stadium Debt Backfire Spurs Restructuring: Muni Credit.

The agency that financed stadiums for three of Houston's professional sports teams is selling debt to extricate itself from municipal-bond deals that backfired with the financial crisis.

The Harris County-Houston Sports Authority plans to borrow about $689 million starting this week to restructure some of its $1 billion of obligations. The debt, mostly backed by tourism-related taxes, was sold to pay for facilities in the fourth-most-populous U.S. city for Major League Baseball's Astros, the National Basketball Association's Rockets and the National Football League's Texans.

Localities are still dealing with financing structures sold by Wall Street banks more than a decade ago with the promise of cutting borrowing costs. For the Harris County agency, the recession triggered events that caused the deal to unravel: The debt's insurer was downgraded, leading the authority to repay $117 million of bonds 16 years earlier than scheduled while also ending swap contracts at a cost of $25 million.

"We've struggled, but this deal will put all of this behind us," J. Kent Friedman, a Houston attorney who is chairman of the authority, said in a phone interview. "We're aggressively trying to get this done by the end of the year."

Debt Trap

This week's offering shows how municipal borrowers trapped in misfiring deals don't have to follow Detroit, where bankruptcy left bondholders with a fraction of their original investment. Investors may also take a loss in Puerto Rico, where the island's electric agency is set to release a plan in March to restructure its $8.6 billion of debt.

The sports authority's approach resembles an October deal from the San Joaquin Hills Transportation Corridor Agency in California, in extending maturities to match expected revenue, said Alan Schankel, managing director of Janney Montgomery Scott LLC in Philadelphia. The revamp will spread the stadium agency's repayment over 12 extra years.

"There's things issuers can do, short of bankruptcy, that move the projects forward," said Schankel. "It's a credit-positive for investors, but its good for the issuer too."

Tourism Cash

The authority, created by the county and the city of 2.2 million people in 1997 to fund sports venues, sold bonds in 1998 for Minute Maid baseball park, and in 2001 for the NRG football stadium and the

Toyota Center basketball arena. The agency also built BBVA Compass Stadium for the Dynamo Major League Soccer franchise without borrowing. That venue opened in 2012.

Backing for the bonds came from income such as a 2 percent tax on hotel and motel stays and a 5 percent car-rental levy. The debt also included variable-rate bonds with interest-rate swaps designed to control borrowing costs.

MBIA Insurance Corp., which guaranteed the variable-rate debt and swaps, was stripped of its last top rating in June 2008 after losses on mortgage-backed securities it insured. JPMorgan Chase & Co., the buyer of last resort for the variable-rate debt, repurchased those bonds, which in 2009 triggered a provision requiring the authority to pay off the securities in five years rather than the scheduled 21.

Wrong-Way Bet

The authority paid to end the swaps in 2011, and this year repaid the accelerated debt using reserves, according to Friedman. The agency had company in paying to exit swaps, which proved wrong-way bets for many localities after the Federal Reserve drove its benchmark interest rate close to zero. Municipal borrowers in the $3.7 trillion market have paid at least $5 billion to banks to end interest-rate swaps, data compiled by Bloomberg show.

The agency met its obligations without missing payments to investors, according to Friedman. Moody's Investors Service had warned in 2010 that the agency might not make its payments.

By pushing the maturity out to 2053, the new structure will create flat payments that align with expected revenue. Previously, the payments escalated through 2041, which would have required the revenue backing the debt to increase.

"We're making it more comfortable for the authority to make debt-service payments," said Friedman. "We're making it less complicated."

Rodeo Bonds

On top of selling $569 million of new senior and junior-lien debt backed by the car and hotel taxes, the authority wants to issue about $120 million of bonds this month backed mainly by payments from the Texans NFL team and a livestock show and rodeo, said Friedman.

The new structure will also provide dedicated reserves and remove the risk that a failure in one part of the structure could trigger defaults of other parts, according to Moody's. Surplus revenue would go toward reserves to repay debt early.

The changes may lead rating companies to raise the authority's ratings. Moody's assigned an A2, its sixth-highest grade, to the new senior-level bonds. That's still seven levels higher than the Ba3 mark of the current senior debt, which Moody's put on review for an upgrade once the restructuring is done. Standard & Poor's gives an A- rating, its seventh-highest, to the new senior debt, and put some existing senior debt on positive credit watch, meaning ratings may rise.

As the authority sells, its finances are improving. Pledged revenue, including lodging and car-rental taxes, are up 36 percent from 2010 to 2013 after falling 12.7 percent from 2008 to 2010, according to S&P. The restructuring also saves $60 million and frees up revenue of $24.5 million in 2014, according to S&P.

"It all worked out and everyone got paid," said John Medina, an analyst with Moody's in New York.

Bloomberg Muni Credit

By Darrell Preston

Dec 1, 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
Mark Tannenbaum, Alan Goldstein

New Jersey Bond Costs Swell Fivefold in Stress Sign: Muni Credit.

New Jersey's relative borrowing costs grew fivefold in its first general-obligation sale in 19 months, signaling that underfunded pensions and revenue shortfalls are rattling municipal-bond investors.

The state issued $525 million of general-obligation debt yesterday in a competitive offer won by Bank of America Merrill Lynch, which beat out seven banks. Bonds maturing in June 2025 priced to yield 2.75 percent, or about 0.5 percentage point more than benchmark munis, data compiled by Bloomberg show. In comparison, the yield spread was 0.09 percentage point for 10-year debt in the state's last long-term general-obligation sale, for $350 million in May 2013, the data show.

Investors are rendering their verdict on policy moves by Republican Governor Chris Christie, 52, who plugged a revenue shortfall in June by cutting $2.5 billion in promised pension payments for this fiscal year and last year. That maneuver, plus three straight years of overestimated revenue and a lackluster recovery from the recession, led the three biggest rating companies to downgrade the state a combined eight times under the governor, the most for a chief executive of the state.

"The spreads should have been much wider based on the deterioration of New Jersey's credit quality," Tom Metzold, co-director of munis in Boston at Eaton Vance Management, which oversees $27 billion of local debt, said in a telephone interview. He anticipates the yield gap will widen to as much as one percentage point within the next year.

Timing, Size

The state treasurer's office calculates that the yield spread rose from 0.23 percentage point in the May 2013 transaction. The increase amounts to $1.4 million a year in additional debt-service costs, and resulted in part from the different time of year and the larger size, according to Christopher Santarelli, a spokesman for Treasurer Andrew Sidamon-Eristoff.

"We would emphasize the market met our GO bonds enthusiastically today with the top eight firms bidding for the entire offering," Santarelli said in an e-mail.

Christie, in his second term, plans to announce next year whether he'll seek the nomination for president in 2016. He's in Canada through Dec. 5 to discuss energy, an issue that will be central to the Republican contest. He visited Mexico in September to press for expanded North American energy ties.

Building Classrooms

Back home, Christie has struggled with New Jersey's budget as revenue falls short of projections

and pension, benefit and debt costs eat up more of annual spending.

The bonds sold yesterday include $450 million to build college classrooms and labs for science, technology, engineering and math programs. The balance is for environmental projects.

Christie campaigned for the $750 million Building Our Future Bond Act, as did Senate President Steve Sweeney, a Democrat. They've said college projects would create construction jobs and attract students, a boost for a state that trails the U.S. and its neighbors in recovering from the 18-month recession that ended in June 2009.

New Jersey's unemployment rate, at 6.6 percent in October, compared with 5.8 percent nationally, 6 percent in New York and 5.4 percent in Pennsylvania.

Casino Faith

Christie's faith in another promised revenue generator, the gambling destination Atlantic City, hasn't paid off, as four of 12 casinos stopped operations this year while a fifth, Trump Taj Mahal, plans to close this month. He has yet to identify a permanent funding source for the Transportation Trust Fund, the highway repair and construction account that will run dry next fiscal year, and hasn't said how he plans to resolve the shortfall in pensions and retiree health benefits.

New Jersey's retirement system had enough assets to cover 32.6 percent of projected liabilities as of June 30, according to a bond-offering supplement released Nov. 25. That compared with 54.2 percent a year earlier.

The lower ratio is because of new Governmental Accounting Standards Board rules that change how states must calculate underfunding. New Jersey was the first to disclose the numbers under the new requirement, Fitch Ratings said in a Nov. 25 report.

New Jersey in 2013 made 28 percent of the required pension payment, the worst among U.S. states, according to Loop Capital Markets, a bond underwriter in Chicago.

'No Signs'

Tom Kozlik, a municipal-bond analyst for Janney Montgomery Scott LLC in Philadelphia, said the funding is the biggest cause for concern that New Jersey debt will grow riskier.

"There are currently no signs that a significant amount of reform will occur to New Jersey's spending or budgeting habits," Kozlik said by e-mail after the bond sale. "Balance requires a significant amount of political will, but the longer state political actors wait, the more politically and financially difficult changes become."

New Jersey requires voter approval to issue general-obligation bonds, which are backed by the state's taxing power. The state had about $35 billion of bonds as of June 2013, including $2.4 billion of general obligations, according to its most recent debt report.

The general obligations are rated A1 by Moody's Investors Service, the fifth-highest investment grade, and A, one step lower, by Standard & Poor's and Fitch. Only Illinois has lower rankings among U.S. states.

Zia Ahmed, a spokesman for Charlotte, North Carolina-based Bank of America, didn't have a comment on the sale.

Bloomberg

By Elise Young and Michelle Kaske

Dec 3, 2014 5:00 PM PT

To contact the reporters on this story: Michelle Kaske in New York at mkaske@bloomberg.net; Elise Young in Trenton at eyoung30@bloomberg.net

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

---

Slowing Cigarette Sales Could put Virginia Tobacco Bond Payments at Risk.

The company that funded Virginia's tobacco commission is spending more money than it takes in, which could leave some big investors feeling burned because they bet people wouldn't quit smoking as fast as they have.

But the Virginia Tobacco Settlement Financing Corp.'s red ink isn't likely to be a headache for the state or its tobacco commission. When Virginia sold investors a half-interest in the annual payments tobacco companies promised it under their multibillion-dollar settlement with states, the paperwork very carefully said the state would not be on the hook if that flow of funds wasn't as big as people expected.

And it hasn't been.

The Settlement Financial Corp. paid Virginia more than $1 billion in return for half the tobacco companies' annual payments to the state. To finance that payment, the Settlement Financial Corp. sold bonds – it raised about $1.2 billion in 2007 by selling bonds with a face value of just over $2 billion, but marketing them at a deep discount to that face value. That translated to a return to investors of nearly 9 percent on its tax-exempt bonds – about twice the rate on U.S. Treasury bonds – and nearly 11.7 percent on its taxable bonds, assuming they are repaid in full in 2047.

That's not looking too likely these days, said Evelyn R. Whitley, the state's director of debt management, who oversees the financing corporation's operations.

Virginia's not alone. In a recent report, Moody's Investor Services estimated that 80 percent of the $97 billion that states raised by selling similar bonds won't be repaid in full if cigarette sales slow even more.

The big cigarette companies have been making smaller payments to states than most experts had forecast when the settlement was negotiated in 1998.

The reason is that smokers have been quitting or shifting to discount brands that aren't participating in the agreement in larger numbers than expected. The participating tobacco companies' payments are based on sales. Last year saw a particularly steep dip. A decline that had averaged about 3 percent a year since 2000 amounted to nearly 5 percent in 2013, in large part because of the rapid growth of e-cigarettes according to municipal bond analysts at UBS Financial Services.

That means revenue from the financial corporation's share of the state payments has been running

as much as $20 million a year below the interest payments it makes on its bonds in recent years.

The corporation got a bit of breathing room in July, when it negotiated a settlement of claims from the bankrupt investment bank Lehman Brothers. That brought in a $13.6 million payment in October, and should mean additional payments in the future, Whitely said.

But shortfalls are likely to continue as more and more smokers quit, and it won't take many years to run through the corporation's $85 million reserve fund, which it taps when its revenue falls short of the interest it has to pay on its bonds, Whitely said.

When that happens, she said, the state has three choices:

- It can let the corporation pull the plug on itself and go into default.
- It can see if the investors who bought the bonds – mostly hedge funds and other investment pools specializing in high risk securities – might be interested in refinancing them, basically by agreeing to accept less than the face value of the bonds.
- The General Assembly could consider giving the corporation a larger share of the state's tobacco settlement revenue.

New Jersey took that third step in March, pledging to pay investors in its tobacco bonds the remaining $60 million a year in tobacco settlement funds that it had been using for other state spending, such as the health programs the settlement was originally designed to fund.

"Investors understood the risks," Whitely said. And with the hefty interest they've received since buying the bonds, "they've been pretty well hedged against the risk."

The Daily Press

Dec 1, 2014

By Dave Ress

dress@dailypress.com

Ress can be reached by phone at 757-247-4535.

Municipal Bond Volume Rises 15.3% in November.

NEW YORK – Long-term municipal bond issuance rose for the fourth month in a row as volume increased 15.3% in November, according to Thomson Reuters data.

Monthly Data

New issue supply rose to $28.330 billion in November as 922 new deals came to market, up from the $24.563 billion in 841 deals that were priced in November of 2013, according to the final report.

November's supply, however, was lower than October's total of $34 billion in issuance.

Tax-exempt volume increased 18.9% in November to $25.684 billion in 842 deals, compared to $21.599 billion in 746 deals in the same period last year. Taxable sales rose 65.4% to $2.138 billion in 69 deals from $1.293 billion in 77 sales in November 2013.

Negotiated sales rose 9.8% to $20.381 billion in 580 deals from $18.556 billion in 468 deals last year. Competitive sales jumped 73.8% to $7.474 billion from $4.300 billion in the same period last year. Private placements plunged 72.2% to $474 million in eight deals from $1.707 billion in 65 deals in November 2013.

While the string of new issue gains has been unbroken for several months, some analysts and traders are predicting a decline in volume over the near- and long-term.

Alan Schankel, a managing director at Janney Capital Markets says his firm forecasts falling issuance through 2017.

Some of the factors Janney sees as keeping issuance low include higher interest rates, which would result in lower refunding amounts and austerity measures instituted by issuers.

But not all had a down outlook for municipals in the short-term.

James Colby, senior municipal strategist and portfolio manager at Van Eck Global, said that November was a good month for the market overall.

“This was a better month for underwriters, issues and all those who wanted to see a bit of variety on the calendar,” Colby said.

Colby said there had been a recent deficit of muni supply versus muni demand.

“The supply and demand gap narrowed in November,” he said. “It was a strong month in terms of supply.”

Data from Siebert Brandford Shank show that municipal bond new issue supply was $264 billion while demand, meaning money from bond calls, maturing bonds and coupon payments, totaled $351 billion as of Oct. 31, according to Van Eck.

Refundings surged 92% in November to $12.075 billion in 401 issues, from 6.291 billion in 257 issues in the same period last year. However, new money issues totaled $11.996 billion in November in 468 deals, down 5.2% compared with $12.653 billion in 513 issues last year. Combined new money and refunding issues totaled $4.259 billion, down 24.2% from $5.619 billion in November 2013.

General obligation bond sales increased 49.9% in November to $12.248 billion in 584 issues from $8.169 billion; revenue bond issuance slipped 1.9% to 16.082 billion in 338 issues from $16.391 billion in 334 issues a year earlier.

Electric power issues showed the biggest gain of the month, rising 228.9% to $724.6 million in 13 issues from $220.3 million in 13 issues last year. Also logging big gains were public facilities bonds, which rose 132.1% to $1.086 billion in 47 issues from $468.1 billion in 52 issues in the same period last year. The biggest losers were development bonds which dropped 58.5% to $454.9 million in 20 issues from $1.095 billion in 39 issues last November; and housing bonds which fell 24.3% to $792.2 million in 36 issues from $1.047 billion in 38 issues in November 2013.

Bond insurance gained in November, rising 16.7% to cover $1.795 billion in 145 issues compared to $1.538 billion in 91 issues in the same period last year. Insured mortgages rose 1,462% to $40.6 million in November in one issue from $2.6 million in a single issue last year.

Meanwhile, municipalities continued to waver in their sales of municipal bonds in November.

State governments issued 14.1% more bonds in November, with the total rising to $3.828 billion in 17 issues from $3.357 billion in 30 issues in the same period last year. But offerings at state agencies declined by 21.5% to $6.308 billion in 88 issues from $8.038 billion in 108 issues last year.

Issuance by counties and parishes dropped 40.2% to $1.818 billion in 51 issues from $3.042 billion in 72 issues last year while issuance in cities and towns rose 17.5% to $2.937 billion in 245 issues from $2.499 billion in 229 issues in the same month last year.

Districts issued $73.5% more bonds at $5.714 billion in 375 deals, up from $3.293 billion in 293 deals last year; local authorities sold $6.950 billion in 131 issues, up 88.8% from $3.680 billion in 2013.

For the year to date, California ranked as the No. 1 state in new municipal issuance with sales of $41.549 billion, down 8.7% from $45.532 billion last year. Texas ranked second, with $34.745 billion in bond sales, up 11.2% from the same 11 month period last year.

THE BOND BUYER

BY CHIP BARNETT

NOV 26, 2014 1:13pm ET

Are Muni Bonds Being Replaced by Direct Loans?

Municipalities and banks are getting friendlier, and it's starting to irk credit rating agencies.

Earlier this year, Wisconsin pulled off a fancy financing maneuver designed to avoid an expected increase in interest rates. Rather than waiting until next year to go to the municipal market and refinance a certain set of bonds, the state got a $278 million loan secured directly from a bank. In doing so, Wisconsin locked in 2014's lower interest rates and can pay off bondholders next year with the proceeds.

This particular refinancing tool, called a delayed draw term loan, is complex and likely only to be used by more sophisticated issuers like large municipalities or states that are very accustomed to selling bonds. But it's one of many examples in recent years where a government has skipped issuing debt in the municipal market and just borrowed the cash instead.

Sometimes, said Cook County, Ill., CFO Ivan Samstein, the best deal is through a bank. "It's the ability to do a lower-cost transaction because of lower fees and a cost of capital," he said. "I think that's what driving issuers to work directly with banks." In recent years, Cook County has refinanced most of its floating rate bonds through banks instead of the market, moving from about $130 million a few years ago to $370 million with banks today.

In fact, over the last five years, banks in general have nearly doubled their municipal holdings to $425 billion in securities and loans, up from $225 billion at the end of 2009, according to a recent Moody's Investors Service report. The practice is becoming so prevalent that muni analysts say it's contributed to the slower pace of new bond issuance over that same five-year period.

The increased borrowing by municipalities has irked credit ratings agencies, leading Moody's and Standard & Poor's to call for better uniform disclosures of bank loans to governments. S&P even

warned issuers that a delay in providing the information could have “negative rating implications.”

Obviously people secure bank loans all the time, so why the fuss when governments do it? The main reason has to do with transparency — like credit analysts and investors who are assessing a government’s risk exposure need to know where that government’s money is going. Large issuers like Wisconsin have already made a habit of notifying the public of any private financings. But as direct loans and other private structures have become more prevalent among smaller, less frequent issuers, credit analysts are often learning about them from year-end audits rather than from the borrower at the time of the loan. That means that, thanks to the lag time in issuing these reports, the full details of a bank deal may not be publicly known until a year after the fact.

And that’s a problem. Ratings agencies aren’t just looking at governments’ comprehensive debt positions but also at the terms associated with these deals, said S&P analyst Henry Henderson. “That’s probably our biggest concern with the direct purchase sector,” he said. “If there are different terms [than a typical loan agreement], we feel that it’s important that’s disclosed to the public.”

Rating agencies are not alone. Like Wisconsin, Cook County is one of the experienced issuers that voluntarily reports its bank deals with the Municipal Securities Rulemaking Board, the body that sets rules for the municipal market and its users. The board doesn’t require governments to disclose bank deals, but two years ago it published guidance on doing so. And starting next year, California is requiring higher standards for disclosing these types of direct loans. The law speeds up the deadline to file loan disclosures to 21 days. (It requires alternative forms of financing be included in existing bank loan transparency regulations.)

It could be a game changer. Not only will it make for a more informed market, Municipal Market Advisors’ Matt Posner points out it could actually reduce California’s borrowing costs because of this more complete picture for investors. And if that happens, other states will likely follow.

GOVERNING.COM

BY LIZ FARMER | NOVEMBER 26, 2014

GASB Issues Preliminary Views on Lease Accounting for State and Local Governments.

Norwalk, CT, November 20, 2014—The Governmental Accounting Standards Board (GASB) today issued for public comment a Preliminary Views, Leases, which includes proposals to improve the accounting and financial reporting for leases for state and local governments from both a lessee and lessor perspective.

Many governments use leasing to finance certain necessary items—including vehicles, heavy equipment, and buildings—without having to actually purchase them. Some governments also serve in a lessor capacity by leasing assets to other entities.

The purpose of the Preliminary Views is to obtain comments from stakeholders on the Board’s views before developing more detailed proposals for changes to existing accounting and financial reporting standards. The Preliminary Views presents the Board’s current thinking on the issues associated with accounting for leases—which are based on the foundational principle that all leases are financings of the right to use an underlying asset.

The document includes proposals on how leases would be presented in the financial statements and essential information related to leases that governments would disclose in the notes.

Under the proposal, lessee governments would report the following in their financial statements for all leases except short-term leases (12 months or less):

- An intangible asset that represents the government's right to use the leased asset
- A corresponding liability for lease payments
- Amortization expense related to the lease asset (recognizing the asset amount as an expense over the term of the lease)
- Interest expense related to the lease liability

Government lessors would report the following in their financial statements for all leases except short-term leases:

- A receivable for the right to receive payments
- A corresponding deferred inflow of resources to reflect resources related to future periods
- Lease revenue (and a corresponding reduction in the deferred inflow) systematically over the term of the lease
- Interest revenue related to the receivable

"The Preliminary Views more closely aligns the accounting and financial reporting for leases with the economic substance of those transactions," said GASB Chair David A. Vaudt. "The Board has an opportunity to make changes to the current guidance on leases that would result in greater transparency, reduced complexity in application, and more meaningful information for financial statements users."

The Preliminary Views is available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposals and provide comments by March 6, 2015.

The GASB will host public hearings on the Preliminary Views on April 8, 9, and 10, 2015. Locations and other details, including instructions for registering to participate, are highlighted in the document.

About the Governmental Accounting Standards Board

The GASB is the independent, not-for-profit organization formed in 1984 that establishes and improves financial accounting and reporting standards for state and local governments. Its seven members are drawn from the Board's diverse range of stakeholders, including preparers and auditors of government financial statements, users of those statements, and members of the academic community. More information about the GASB can be found at its website, www.gasb.org.

GASB Issues Preliminary Views on Reporting Governments' Fiduciary Responsibilities.

Norwalk, CT, November 20, 2014—The Governmental Accounting Standards Board (GASB) today issued for public comment a Preliminary Views, Financial Reporting for Fiduciary Responsibilities.

The Preliminary Views presents the Board's current thinking on fundamental issues associated with the reporting of activities in which a government has a fiduciary responsibility. In this context,

fiduciary responsibility generally relates to a government controlling assets belonging to others in a trustee or custodial capacity.

The Board's primary objective in this project is to enhance the consistency and comparability of when and how governments report their fiduciary activities in basic financial statements. The purpose of the document is to obtain comments from stakeholders before developing more detailed proposals for changes to existing financial reporting standards.

"The current state and local government accounting and financial reporting literature does not adequately define what constitutes a fiduciary responsibility," said GASB Chair David A. Vaudt. "The changes the Board is proposing would give governments and their auditors clearer guidance for determining which activities should be reported in fiduciary funds and in which type of fiduciary fund the activities should be reported."

The Preliminary Views proposed by the Board, if approved as a final Statement, would enhance reporting of fiduciary activities by:

- Defining when a government has a fiduciary responsibility and, therefore, is required to present fiduciary fund financial statements
- Clarifying financial reporting requirements for fiduciary responsibilities, including a requirement for business-type activities that serve in a fiduciary capacity
- Introducing the use of a financial statement that reports the inflows and outflows of resources for all fiduciary fund types

"This proposal would provide financial statement users with needed information regarding both general and special-purpose governments, including business-type activities such as public universities, hospitals, and utilities, which generally have not reported their fiduciary activities in the past," said Mr. Vaudt.

The Board's views presented in the document were informed based on extensive outreach with stakeholders during the pre-agenda research phase.

The Preliminary Views is available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposals and provide comments by March 6, 2015.

The GASB will host public hearings on the Preliminary Views on April 8, 9, and 10, 2015. Locations and other details, including instructions for registering to participate, are highlighted in the Preliminary Views.

About the Governmental Accounting Standards Board

The GASB is the independent, not-for-profit organization formed in 1984 that establishes and improves financial accounting and reporting standards for state and local governments. Its seven members are drawn from the Board's diverse range of stakeholders, including preparers and auditors of government financial statements, users of those statements, and members of the academic community. More information about the GASB can be found at its website, www.gasb.org.

S&P: U.S. State OPEB Liability is Stabilizing, But Funding Remains Low, Report Says.

NEW YORK (Standard & Poor's) Nov. 17, 2014–Total unfunded state other postemployment benefit (OPEB) liabilities are stable from last year, although funding ratios remain low for the nation's combined $529.8 billion in liabilities, said a report published today by Standard & Poor's Ratings Services.

The report entitled,"Diverging Trends Underlie Overall Stable U.S. State OPEB Liability," highlights states that have done the most to reduce absolute OPEB liabilities, led by North Carolina, Michigan, and Hawaii, as well as those for which liabilities have actually increased, including Texas, New Jersey, and Alaska. The report also notes that proposed changes to the Governmental Accounting Standards Board (GASB) to make future OPEB reporting align with new standards for pension reporting could improve the ability to compare OPEB liability across states.

A companion to this OPEB report, "Proposed GASB Changes To OPEB Reporting Could Enhance Comparability But Reduce Information On Funding Progress," also published today, outlines proposed GASB changes and the effect they could have on how states report OPEB liabilities. If implemented, the new rules could improve OPEB comparability but obscure information on a state.

Standard & Poor's annual survey of U.S. states OPEB liabilities shows only a 0.1% decline from last year's report, showing some states' practical measures to address rising health care costs and the largely unfunded status of OPEB trusts, taking into account divergence among states.

"We believe states' efforts to address OPEB liabilities have slowed the growth in total unfunded liabilities in the past several years," said Standard & Poor's credit analyst Sussan Corson.

"Funding ratios have also improved slightly for most states that have established OPEB trusts, and changes to certain states' OPEB plan design or eligibility requirements have also led to declines," Ms. Corson continued. "Conversely, some states continue to report rising OPEB liabilities that could eventually pressure budgets and credit unless addressed," Ms. Corson concluded.

Despite the overall stability of state OPEB funding, several states have reported large changes in their actuarial unfunded liability since our last survey. The largest absolute decline in unfunded OPEB liabilities based on updated OPEB valuations in the past year occurred in Michigan, North Carolina, and Hawaii.

The OPEB report also notes the effect of the Patient Protection And Affordable Care Act on long-term health care costs that will continue to affect states and could provide both opportunities and costs.

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.

The report is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-7280 or sending an e-mail to research_request@standardandpoors.com. Ratings information can also be found on Standard & Poor's public Web site by using the Ratings search box located in the left column at www.standardandpoors.com. Members of the media may request a copy of this report by contacting the media representative provided.

Publication date: 17-Nov-2014 11:02:48 EST

Primary Credit Analyst: Sussan S Corson, New York (1) 212-438-2014; sussan.corson@standardandpoors.com

Media Contact: Alex Ortolani, New York 212-438-5054; alex.ortolani@standardandpoors.com

No content (including ratings, credit-related analyses and data, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P. The Content shall not be used for any unlawful or unauthorized purposes. S&P, its affiliates, and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies

and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain credit-related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280 or by e-mail to: research_request@standardandpoors.com.

Pensions Case Study: North Riverside.

Illinois' municipal pension shortfall, excluding Chicago, has spiked to more than $12 billion from $1 billion just a decade ago. Municipalities are suffering the consequences. They're cutting core services, raising taxes and adding new fees to pay for their increasing government-worker pension costs.

The problem is local governments have their hands tied when it comes to pension reform. The Illinois state legislature sets municipal pension laws with no regard to whether the local budget and taxpayers can afford them.

But the village of North Riverside found a way to get around the General Assembly's road block to pension reform. North Riverside plans to move its entire fire department to a private provider of fire protection services – a private provider with a 401(k)-style retirement plan. The village plans to transfer its 12 firefighters and four lieutenants – and their full salaries – to the same private company that's been providing the village's ambulance service for nearly 30 years.

Continue Reading.

ILLINOIS POLICY

BENJAMIN VANMETRE

NOVEMBER 11, 2014

Pay-for-Success Is Gaining Momentum, Study Finds.

The inaugural round of grants from the federally funded pay-for-success program is already spurring growth of performance-based contracting nationwide, according to a recently published report.

"It is a little like throwing a match on some dry kindling," said Patrick Lester, director of the Social

Innovation Research Center and the report's author.

In October, the program, administered by the Corporation for National and Community Service, announced $12-million for eight grant recipients. They included the Harvard Kennedy School Social Impact Bond Technical Assistance Lab, Third Sector Capital Partners, and the Corporation for Supportive Housing. The grantees play a critical intermediary role in performance-based contracting, identifying communities in need and making subgrants to government agencies and direct service providers.

Continue Reading.

The Chronicle of Philanthropy

By Megan O'Neil

November 17, 2014

Jones Day: Nine Lessons From Detroit's Chapter 9 Case.

On November 7, 2014, Judge Steven Rhodes, the judge presiding over the City of Detroit's bankruptcy case, announced that he would confirm the City's proposed Plan of Adjustment (the "Plan"), including the creditor settlements contained within that Plan. A more detailed written opinion will follow, but the opinion read from the bench on November 7, together with an earlier opinion in this case, are among the most important precedents in U.S. municipal bankruptcy law. Indeed, the City's bankruptcy proceedings more generally—the significant reduction of both bond and pension and retiree health debt, the speed with which the City emerged from bankruptcy, and the largely consensual nature of the Plan—make clear that municipal bankruptcy law can be successfully used to restructure debt and provide a fresh start to cities, counties, towns, school districts, and other general-purpose municipalities.

The Plan that Judge Rhodes confirmed is itself noteworthy. It eliminates more than $7 billion of Detroit's debt and other legacy liabilities and defers repayment of the principal of most of the remaining unsecured debt for at least nine years. Apart from reducing the City's debt load, the plan makes about $1.7 billion available over the next 10 years for restructuring and reinvestment initiatives to address blight, restore the City's infrastructure, and enable the City to improve the services it delivers to residents, especially those promoting public safety. That a Plan of Adjustment with these features was even proposed is a radical departure from what has been the norm in municipal restructurings. Most of the time, municipal restructurings involve modest, if any, adjustments to debt, with austerity measures imposed on the debtor municipality after years of chapter 9 litigation. Here, the City's Plan of Adjustment was proposed, ultimately accepted by almost all classes of creditors, and judicially approved in less than 17 months from the date of the City's chapter 9 filing. That is nothing short of remarkable.

The agreements embodied in the City's Plan of Adjustment, as well as Judge Rhodes's rulings, thus provide several important lessons for investors, municipal and state leaders, and public-sector labor unions.

1. Unsecured creditors have more limited rights against governmental borrowers than against corporate ones. For example, municipal unsecured creditors usually cannot attach, levy against, or otherwise compel the sale of assets of a municipality, whether such assets are

characterized as core or not. Frequently, municipal unsecured creditors can collect only out of the municipality's excess cash (unlikely to be available when a municipality is in distress) or the proceeds of increased taxes (if taxes can be increased without further damaging the municipality's ability to retain residents and businesses). Judge Rhodes determined that the commencement of a chapter 9 case does not expand these rights.

2. General obligation ("GO") bonds, usually regarded as the safest type of municipal bonds, are not immune from impairment in a chapter 9 bankruptcy. While GO bonds often are said to be "secured" or backed by a "pledge" of the taxing power of the municipality, these bonds are not necessarily actually secured by collateral. Instead, in municipal finance, these terms may mean only that the issuer has promised to pay the bonds out of a specified revenue stream and that it will raise taxes to do so if necessary. Judge Rhodes noted that the question of whether one type of GO bond represented a secured claim that is enforceable in bankruptcy was a "coin toss." As to a second type of GO bond, his opinion suggests that there was an approximately 75 percent probability that it would be regarded as unsecured and that the settlement that resulted in a 41 percent distribution to holders of such bonds was at the high end of the range of reasonableness.

3. Where a municipality cannot provide essential services, the municipality's need to do so may well come before the interests of GO bondholders and other creditors. If there are real constraints on raising taxes—for example, if tax delinquency rates are already high or the municipality will suffer further decline by raising taxes—bankruptcy courts will not require the municipality to increase taxes. In other words, all creditors, including GO bondholders, are exposed to risk if the municipality cannot provide adequate services to its residents and its tax base is stressed.

4. Municipal bonds often do not include certain protections that are becoming standard in corporate debt instruments, subjecting municipal bondholders to avoidable risks. In Detroit, holders and insurers of municipal bonds secured by special revenues were seemingly surprised to learn that bankruptcy courts may well have the power to reset bond interest rates if the rates are above market levels when a plan is considered for confirmation. This has been the law in corporate bankruptcy for at least 35 years, and corporate debt documents have evolved to include "make whole" provisions that, when properly drafted, may substantially protect bond holders from interest rate reductions. Not one of the City's debt documents included these provisions. Few municipal bonds do.

5. State-law limits on a municipality's ability to issue and collateralize debt are important, and the legality of debt instruments designed to circumvent such limits is highly questionable. In Detroit, some lenders had accepted obligations that were structured to avoid the City's debt limits. Ordinarily, legal opinions protect investors from this kind of risk, but in appropriate cases, the opinions can successfully be challenged. As a result, holders of some obligations face the real possibility that their claims might not be enforceable at all.

6. State constitutional protections for accrued pensions, like protections against the impairment of contracts more generally, give way to federal bankruptcy power. As a result, accrued but unfunded pensions are likely not immune from impairment by a federal bankruptcy judge. In perhaps the most widely reported decision in the City's case, Judge Rhodes held that the Michigan Constitution's Pensions Clause, which provides that accrued pension benefits are "contractual obligations" that cannot be "diminished or impaired" by the state or its political subdivisions, stood as no obstacle to the impairment of pension claims in chapter 9. That Clause, Judge Rhodes held, merely conferred contractual status on pension claims, and the bankruptcy court's power to impair municipal contracts is well-established—indeed, municipal bankruptcy would be worthless without it. In Stockton's bankruptcy case, Judge Klein recently reached the same

conclusion with respect to similar protections under California law.

7. In the face of unsustainable pension obligations, the emotional, hot-button issue of pension cuts can be consensually resolved with shared sacrifice. Struggling municipalities often are confronted with large pension obligations. Faced with shrinking tax bases and increasing life expectancies, not to mention cost-of-living adjustments and other promises that may have been unrealistic evenwhen made, many municipalities face unfunded pension obligations that cannot be satisfied. The decisions by Judge Rhodes make clear that these obligations can be reduced to realistically fundable levels and that these reductions can be achieved through agreement with retiree interest groups. In Detroit, the agreements also established hybrid pension plans to deliver future pensions for active employees. Such arrangements combined elements of defined benefit and defined contribution programs, and they may be a blueprint for pension reform in other distressed municipalities.

8. Customary funding assumptions for public pension plans may well be unrealistic. As the City's pension expert testified, U.S. public pension plans historically have had "a policy that essentially believes that investment gains [are] permanent and losses [are] temporary." Government and labor leaders, and their pension trustee appointees, need to eschew these "bet on the come" assumptions in favor of more conservative funding and investment approaches. Indeed, in his oral opinion, Judge Rhodes expressly embraced the importance of labor leadership bargaining for appropriate funding of pension benefits, and he admonished labor unions, the City of Detroit, and the State to employ more "honest and realistic accounting and actuarial" assumptions for both pension funding and liability disclosure. Negotiating for ever-increasing pension benefits and assuming that they will ultimately be funded may no longer be an appropriate bargaining strategy.

9. Differences in treatment of unsecured creditors does not necessarily lead to a finding of "unfair discrimination." As Judge Rhodes saw it, the recovery for a class of unsecured pension claims was estimated at as much as 60 percent while the recovery for another class of unsecured creditors was estimated at 13 percent. To Judge Rhodes, this was not unfair discrimination for several reasons: the City had a "strong interest in preserving its relationships with its employees and in enhancing their motivation, consistent with its financial resources," the discrimination was related to the City's mission of providing adequate services to residents, and more favorable treatment of pension claims was consistent with the reasonable expectations of creditors given the Pensions Clause in the Michigan Constitution. This determination will be surprising to many municipal bond market observers who have noted that in many prior cases, claims of bondholders have received greater recoveries than the claims of municipal employees.

To be sure, and fortunately, chapter 9 bankruptcy cases and even municipal defaults are likely to remain rare. Indeed, municipal bonds will likely remain relatively safe investments, and many municipalities have strong tax bases, carry reasonable amounts of debt, and can provide services that are sufficient to retain or even attract residents and businesses. Nevertheless, when evaluating debt of issuers with weaker tax bases and higher debt loads, or extraordinary and unsustainable legacy liabilities, the Detroit case provides important lessons for all municipal stakeholders. And for municipalities that are inexorably headed to insolvency, the Detroit chapter 9 case provides a playbook for the swift and successful application of chapter 9.

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

Last Updated: November 21 2014

Article by Bruce Bennett, Evan Miller, Beth Heifetz, Heather Lennox, Corinne Ball and David G.

Heiman

Jones Day

S&P: Detroit's Bankruptcy Plan Outcome Will Not Lead to a Reevaluation of Recovery Assumptions for Bond Insurers.

The approval of Detroit's plan of adjustment will require the legacy bond insurers to continue to make claim payments related to the city's unlimited tax General Obligation (GO) bonds. When considering the claims the bond insurers have already paid and those they will pay in the future, the ultimate loss given default for bond insurers' insured exposures in the aggregate is approximately 26% of debt service. The claims that Assured Guaranty Ltd. (Assured) and National Public Finance Guarantee Corp. (National) will make on future debt service for their unlimited tax GO insured exposure are much less than 26%, with Detroit responsible for the balance of the payments. For Assured and National, the capital adequacy analysis Standard & Poor's Ratings Services…

Purchase the Report.

Report Published 2014/11/20

States' Finances Are Now on Solid Ground: Barron's.

U.S. states represent one of the most secure areas of the global bond market, typically benefiting from low debt levels relative to the size of their economies, and the ability to cut spending and raise taxes during tough times.

Even when hefty pension obligations and unfunded employee health-care liabilities are taken into account, state credit quality generally is strong. The $518 billion of state general-obligation bonds and other state-supported debt are probably the best slice of the $3.7 trillion municipal-bond market. General-obligation bonds are backed by the issuer's full faith and credit.

"The most important factor about state credit quality is that states are sovereign entities that have the ability to raise revenues or cut spending as needed," says Tom Kozlik, a municipal analyst at Janney Capital Markets in Philadelphia. There hasn't been a state-government default since the Depression.

Reflecting all of this, both Moody's Investors Service and rival Standard & Poor's give a triple-A rating to 15 states. Only Illinois and New Jersey have a Moody's rating below double-A. In contrast, just three U.S. companies, ExxonMobil (ticker: XOM), Microsoft (MSFT), and Johnson & Johnson (JNJ) have triple-A ratings from both rating agencies. Even the U.S. government lost its triple-A rating from S&P in a controversial 2011 action, and mighty Apple (AAPL), with its $120 billion of net cash and $40 billion of annual income, merits only a double-A1 rating from Moody's and a AA+ from S&P, a notch below triple-A.

"While most state credits are stable and have improved in the past three years, a few have struggled. Illinois, New Jersey, and Connecticut aren't fully funding their pension obligations, have thin financial reserves, are structurally imbalanced, and are using one-time revenue sources to

balance budgets," says Jim Evans, a portfolio manager at Eaton Vance, an investment manager with a specialty in municipal bonds.

Atop the list are North Dakota, Wyoming, and Utah, which boast modest liabilities, ample cash, and strong economies.

New Jersey's fiscal woes, which stem largely from a lackluster economy and persistent underfunding of its pension program, could have political implications if Republican Gov. Chris Christie enters the 2016 presidential race.

Fiscal trends generally have been positive. Nearly every state has enacted some pension reform since 2009 that either reduces benefits or increases employee contributions, and debt issuance has been light in the past two years. And laggards New York and California have shown improving finances and garnered rating upgrades.

There are some negatives. State tax revenue fell 1.2% in the second quarter, marking the first quarterly drop since 2009, Rockefeller Institute data show. And many states continue to underfund their pension plans. Most have set aside no reserves to finance postretirement health-care benefits for employees. These expenses are paid annually out of the state budget. In that regard, some investors are worried about the Detroit precedent. Bondholders fared worse than pensioners in the city's bankruptcy settlement, and that treatment could be repeated if a state gets into financial distress. The situation is the same in troubled Puerto Rico. Island politicians are putting local interests and constituents ahead of bondholders.

STATE GENERAL-OBLIGATION, or GO, debt has rallied this year in a strong muni-bond market. Total returns (income plus capital appreciation) so far in 2014 on long-term munis are about 13%. When Barron's looked at the states a year ago ("Munis on the Mend," Cover Story, Oct. 14), most state GO debt with maturities of 30 years carried yields in the 4.2% to 4.7% range, with the only outlier being Illinois, whose debt yielded about 5.75%. The 30-year Treasury stood at 3.75%. We argued then that state GOs were a "good play for risk-averse investors."

It's harder now to get excited about state GOs—and other munis—with many long-term state GOs offering yields in the 3.2% to 3.6% range. Illinois remains an exception, with a 4%-plus yield. California's 30-year debt is about 3.45%, and Connecticut's, 3.6%, while top-rated states like Virginia and Minnesota are closer to 3.2%.

New Jersey long-term general-obligation debt yields about 3.75%, but it trades lightly because only about $2 billion is outstanding. The more actively traded bonds are the state's $32 billion of debt supported by legislative appropriation, such as the New Jersey Transportation Trust Fund Authority. These carry a slightly lower rating than Jersey GOs and can yield 4.25% or more.

Yields on state general-obligation paper compare favorably with the 30-year Treasury's 3%, especially on an after-tax basis. Yet, absolute yields aren't high and provide little cushion above inflation, and investors could suffer sizable losses if rates do rise and they sell their bonds before maturity.

The table on this page shows the yield premium, measured in hundreds of a percentage point, of 10-year state general-obligation debt above a triple-A benchmark, now 2.15%. Reflecting strong state credit quality, most 10-year GOs trade close to the triple-A benchmark. It should be said that ratings and spreads for some states are more indicative than real, because they have little or no GO or state-supported debt outstanding. These include Nebraska, Wyoming, and North and South Dakota.

Barron's has looked at state financial health for the past three years using data compiled by Eaton Vance. This year's tally differs from last year's because it offers a more comprehensive picture, based on about 10 measures that factor in assets, liabilities, and other gauges of economic health. The 2013 rankings were based only on the states' debt and pension liabilities relative to their economic output. That approach had merit because it highlighted the growing pension burden in many states—an issue to which many investors have paid little attention.

The broader approach taken by Eaton Vance this year offers a holistic look at state finances beyond debt and pension liabilities. The firm has added other post-employment-benefit, or OPEB, liabilities, which is dominated by unfunded health-care obligations to get a more complete snapshot of state liabilities. The total of those three figures, relative to each state's economic output, is shown in the table on page 24.

PENSION AND HEALTH-CARE liabilities matter because they dwarf outstanding state debt and aren't easily extinguished, thanks to legal protections. Eaton Vance puts unfunded state pension and health-care costs nationwide at $1.6 trillion, or three times the amount of state debt. The firm estimates health-care liabilities because states don't provide much information on which portion is their responsibility and which portion is the obligation of local governments. Eaton Vance assigns the full health-care burden to the state, meaning the liability could be overstated. Whether overstated or not, unfunded postretirement employee health-care liabilities are a major problem for state and local governments. In the Detroit bankruptcy, one of the city's largest obligations was unfunded health-care costs.

Other factors that figure in Eaton Vance's proprietary analysis include the funding status of state pension plans and whether states are making the actuarially mandated contribution to their pension fund each year.

Some states, such as New York, have made ample annual contributions, while others, including New Jersey, Pennsylvania, and Illinois, have not. To balance their budgets, these states have skimped on their pension contributions in recent years, but that simply defers the ultimate payment and has contributed to their weakening credit quality.

To evaluate debt-payment ability, Eaton Vance incorporates the asset side of states' balance sheets by looking at cash and investment levels. It also focuses on several economic indicators, including the jobless rate, the state's gross-domestic-product growth, wealth, tax burden, and population gains. The firm assigns different weights to each of the measures to come up with an overall state ranking.

"To get a true measure of state rating, you have to look at liquidity reserves and the health of the state economy and the state's ability to raise taxes," says Bill Delahunty, director of municipal research at Eaton Vance.

THE TOP THREE STATES aren't necessarily tops in the two categories shown in the table. In fact, North Dakota is 14th nationally in the debt, pension, and health-care measure.

Delahunty says that North Dakota is a prime example of why it's important to look beyond the debt, pension, and health-care total. The state has the lowest unemployment rate in the country, 2.7%, thanks to an energy boom, and it has had the highest economic-growth rate of any state over the past three years. North Dakota also has a large cash pile—enough to fully fund its pension plan and still have ample liquidity left over.

Wyoming has a healthy economy, minimal debt, the lowest tax burden of any state, and a large cash

hoard, sufficient to support its budget for four years. And, Delahunty says, the state could fully fund its pension plan with a modest contribution from its rainy-day fund.

Wyoming Gov. Matt Mead emphasizes the importance of pension funding. “If I were a company moving to a state, I would want to know how those pension plans are doing because I wouldn’t want to make a 20-year commitment to a state that’s going to raise taxes because they’re underwater on their pension plans,” he tells Barron’s.

With no state income tax, Wyoming is an anti-California—and it plans to stay that way. “I think it’s very tempting sometimes to raise taxes if you want to raise revenue. But when I’ve seen the economic development we’ve had in the past 3½ years, I’m telling you, it’s a huge deal to have the lowest taxes in the country,” Mead adds.

Utah has little debt and makes ample annual contributions to its pension plan. The state also has one of the lowest jobless rates in the country and the second-highest median household income, adjusted for the cost of living, behind Virginia.

Despite Utah’s sterling credit quality, Gov. Gary Herbert argues that there’s room for improvement, such as cutting the state’s modest debt of $2.6 billion. “It’s just a little bit high. Either way, we’re one of only nine states with a triple-A bond rating [from all three main rating agencies]. So we’re in pretty good shape. I just want to make sure we don’t jeopardize that.”

Alaska had the country’s largest pool of cash and investments, totaling $69.6 billion at the end of its fiscal 2013, stemming largely from energy taxes. That money is sufficient to fund the northernmost state’s annual budget for five years, and Alaska is contributing money from that fund to shore up its pension plan.

The worst-ranked states, Illinois and New Jersey, do poorly when gauged by most key metrics. Illinois has the worst-funded pension plan among the 50 states—just 30%—based on Moody’s analysis. Its total unfunded pension liability of $168 billion also is the second worst in the country behind California, says Moody’s. And Illinois has one of the highest rates of unemployment, at 8.4%.

In addition, Illinois’ finances could get pressured because temporary income-tax surcharges start to expire on Jan. 1, 2015. “Illinois is underfunding its pension plan, and it’s getting more and more difficult to climb out of that hole,” Delahunty observes.

PERSISTENT PENSION underfunding in the administration of Gov. Chris Christie and his predecessors is plaguing New Jersey, which has one of the lowest funding ratios of any state and the worst average annual pension contribution over the past three years, relative to actuarially required levels. The worsened outlook has come despite the pension reforms that Christie pushed through in 2011.

“New Jersey continues to struggle with structural imbalance, and the governor’s decision to reduce pension contributions in fiscal 2014 and 2015 highlights the fact that the state lacks the revenues to comply with its own agreed-on contribution to the pension system,” S&P wrote in explaining its downgrade of New Jersey general-obligation paper to A from A+ in September. The rating agency added that the state is closing its budget gap by employing “one-time measures, such as legal settlements, debt restructurings, and pension-payment deferrals.”

Big, scheduled, annual increases in the New Jersey pension contributions, to $4.8 billion in fiscal 2018 from $2.25 billion in the current year, threaten to crowd out other state expenditures. And with the nation’s second-highest combined state and local tax burden behind New York, the Garden State

has little room to hike taxes.

Pennsylvania, ranked No. 47, has been hurt by a weak economy and a growing pension liability. These factored into a Moody's downgrade in July, when the state's credit rating fell to Aa3 from Aa2. Tax-revenue growth has been sluggish since the recession, despite the state's energy boom tied to hydraulic fracturing in the vast Marcellus shale deposit.

Pennsylvania has a low, flat income tax rate of 3.1%—below the top rates of almost 9% in neighboring New Jersey and New York—but a tax increase looks unlikely.

Janney's Kozlik regularly is asked by investors about Pennsylvania's relatively low income tax. "Try running for governor in Pennsylvania and telling residents that you're going to raise their taxes because people in New York and New Jersey are paying more," he says. The combined state and local tax bite in Pennsylvania, however, is in the top quartile in the country, according to data from taxfoundation.org.

A sluggish economy and weak pension funding are weighing on Connecticut. The state also has lost some of its appeal as a tax haven for New Yorkers because its top income-tax rate has risen to almost 7%.

NEW YORK is a bright spot in the fiscally challenged Northeast, thanks to the strength of the New York City economy, spending restraint, and conservative financial management, including strong pension funding. The state's unfunded pension liability is just over half of smaller Connecticut's. The Empire State continues to rely too heavily, however, on the superwealthy, including hedge fund managers and private-equity chieftains, who pay a large chunk of the state's income taxes. And the volatile income tax kicks in 60% of state revenue, about twice the national average.

California so far is defying supply siders who argued that a 2012 tax increase that lifted the top income-tax rate to 13%—for those earning more than $1 million—would drive the affluent out of the state. It has the highest top tax rate in the country and doesn't offer a preferential rate on capital gains, which has meant that those cashing in options and restricted stock at highflying technology companies like Facebook (FB) and Twitter (TWTR) face a stiff combined federal and state capital-gains tax bite. California got a Moody's upgrade to AA3 from A1 in June, and the rating agency recently cited the state's "rapidly improving financial position." California has gone from having huge budget gaps after the 2008 recession to boasting a surplus in the latest fiscal year.

Like New York, California is heavily dependent on its income tax, which similarly kicks in 60% of revenue and is paid disproportionately by its ultra-rich. Structural impediments also are a problem in tough times because it takes a vote of two-thirds of the legislature to raise taxes.

PUERTO RICO REMAINS in a class by itself, with far higher yields than those of any state and a poor economic and financial situation. The commonwealth's benchmark 8% bond due in 2035 that was sold in a $3.5 billion deal in March now trades at 87 cents on the dollar for a 9.4% yield. That's equivalent to a 15% on a fully taxable bond for someone in the top federal tax bracket. Few dollar-denominated bonds from any country yield so much, even before the tax benefit.

The issue for investors is whether that yield compensates for the risk, especially after Puerto Rico enacted legislation that is expected to lead to the restructuring of certain public utilities, including the island's electric and highway authorities. Reflecting this, the long-term debt of the public authorities trades around 50 cents on the dollar. The commonwealth's strategy is to wall off its GO debt and tax-supported Cofina bonds—the name comes from the Spanish words for Puerto Rico Sales Tax Financing Corp.—from the troubled authorities.

There's little evidence that the depressed Puerto Rican economy is turning around, and the island remains burdened by a badly underfunded pension plan. Eaton Vance analysts cite other negatives, including high electricity costs, population loss, and a looming budget gap in the current fiscal year, despite major initiatives to finally achieve balance. The commonwealth is considering a $2.5 billion bond issue in the coming months that would offer a fresh test of investor demand.

Aside from Puerto Rico and a handful of states, credit quality is strong at the state level, making municipal bonds an attractive option for income investors. Too bad muni yields are so low.

BARRON'S

By ANDREW BARY

November 22, 2014

Additional reporting by Alexander Eule.

E-mail: editors@barrons.com

Wall Street's Taxpayer Scam: How Local Governments Get Fleeced — and So Do You.

A trick Wall Street uses with municipal finance is to make it seem complex. It isn't — here's what you should know

The news was buried somewhat by all the hubbub over President Obama's executive orders and the (manufactured) scandal over Jonathan Gruber (aka, History's Greatest Monster) but earlier this week, a movement to rein in Wall Street took a step activists hope is just the first of many. Galvanized in part by a recent blockbuster investigation on the damage done by a series of loans taken from Wall Street by Chicago Public Schools — which have not panned out and which Mayor Rahm Emanuel is trying to disown — opponents of Wall Street's "predatory loans" demanded action, using a new report from the Roosevelt Institute as a guide.

Titled "Dirty Deals: How Wall Street's Predatory Deals Hurt Taxpayers and What We Can Do About It," the report is an in-depth look at one of Wall Street's most insidious but overlooked practices that also tackles how government officials can fight back — assuming, of course, that they're interested. Earlier this week, Salon called Roosevelt Institute fellow Saqib Bhatti to discuss his findings and recommendations for what those concerned about Wall Street malfeasance can do next. Our conversation is below and has been lightly edited for clarity and length.

Could you explain to me what the relationship is like between Wall Street and municipal governments? Or is it too varied to say there's any single dynamic?

There are, of course, some nuances from place to place, but in general there are some broad trends. The relationship between municipalities and Wall Street is largely broken because there's a very strong imbalance of power that exists or, at least, is perceived to exist. Banks typically set the rules of the game. They make recommendations for different types of deals municipalities should be doing, they pitch deals to them. Typically, municipalities may bargain around the margins but largely accept the rules as they're set by Wall Street.

When I say there's a perception of imbalance of power I use that word because, in reality, municipalities could have a lot more power if they chose to wield it. If they actually chose to play hardball or question some of the underlying assumptions that Wall Street brings into various municipal finance deals, they could potentially fight to get a better deal or to question the entire framework around how some fees are structured and so forth.

And why is it that municipal governments even go down this road, dealing with banks? What makes this so irresistible?

The reality is that there really is a revenue crisis in our country that's really affecting city and local governments. Over the course of the last 35 years it's been very hard to raise revenue, and so there are real budget problems that exist. Typically, what this means is that cities and states regularly have to borrow money and often the pitch from banks is, "Here's a way you can borrow for less!" or "Here's a way you can save some money!" That's typically how it's framed, as an exciting new product that can save you money. But what often isn't factored in there is that new product could have a lot of risks built-in, and those risks actually have a dollar value and a real cost.

And those would be the "predatory deals" you refer to in the report's title. How are you defining a "predatory" deal?

I think a predatory deal is one that really takes advantage of the vulnerabilities in the customer. I'd say they are typically characterized by high costs, high risks, high levels of complexity, and they're often designed to fail or designed in a way where the bank is not concerned if they do fail.

Do officials tend to know that these deals are structured in such a disadvantageous way? Do they think that for whatever reason they'll make it work or outsmart the banks? Or do they often not know what they're getting into?

One of the big problems is that often the banks really downplay the risks or misrepresent the likelihood of the risks occurring. Often, government officials are really not aware that the risks could actually materialize. One of the things that's featured prominently in the report is interest rate swaps. With interest rate swaps, in particular, one of the big problems was that there's all sorts of risks that were embedded in the deals, and in the paperwork there's all these disclosures that say these risks exist, but when the banks actually pitched the deals the pitch said not to worry about those risks. Or they would make projections of all the money the city could save but those projections were all based on none of those risks materializing.

Especially with products that are relatively new, that are not widely understood and where, frankly, in many cases they haven't been around long enough to really understand what all the risks are, there is this huge problem that exists. The risks just are not disclosed on a level that they should be and in reality, that's not just unethical, it's also illegal and violates the Fair Dealing Standards of the Municipal Securities Ruling Board.

So to take this more into the here-and-now, can you tell me a bit about a recent news story or event that involves this issue?

There was a great Chicago Tribune investigation last week that looked at financial schemes that Chicago public schools (CPS) got into. CPS took out a series of auction rate securities, which they then linked together with interest rate swaps, and the idea was, it was pitched to CPS as a way to get a cheaper interest rate than taking out a traditional fixed-rate bond. A hypothetical example would be that if you were to take out a fixed-rate bond it might cost you 8 percent and the banks were basically saying that if you do this complicated scheme that involves all these auction rate

securities and interest rate swaps and a few other things, you can essentially lock in a synthetic fixed rate of 6 percent, which is cheaper than 8 percent, and so you can save some money.

The problem was that there were a lot of risks associated with this. For instance, the 6 percent was not really a 6 percent. The synthetic fixed was actually not fixed because there were other variables in there that made it so that you weren't really getting a fixed rate. There are traditional costs that were not properly represented to CPS. One of the other problems that existed in particular was that when the banks projected cost savings, they compared the deal to a more expensive one that CPS wouldn't have gotten, so in this case it's as though they made a cost-saving projection that was predicated on the idea that CPS would pay 9 percent otherwise, when, in reality, CPS would have paid 8 percent. They inflated the cost of the alternative to make it seem like a better deal.

There are a number of similar things that went on. One of the problems that eventually surfaced in those deals was that the auction rate securities market completely froze up. When that happened, the variable interest rate on the underlying bonds actually skyrocketed. At the moment at which Bank of America in 2007 underwrote some of these auction rate securities deals, Bank of America officials were already aware of the fact that the market was headed for a meltdown — that's an exact quote from the Tribune, "headed for a market meltdown" — and did actually still underwrite the deal for CPS to get these auction rate securities and didn't warn CPS of this fact. That risk was not actually disclosed to CPS.

In reality, the bigger thing is that — and this is the part that's often lost on public officials, unfortunately — when Wall Street banks are pitching deals their No. 1 goal is not to save money for taxpayers. Their No. 1 goal is to maximize profits for themselves. In this hypothetical situation where a bank says, "You can get a fixed rate for 8 percent or a synthetic fixed for 6 percent," the reason they're steering you towards the 6 percent deal is that they get to charge more fees because that deal is more complex. In a traditional fixed-rate bond, if the interest rate is 8 percent the banks get to charge some fees upfront for underwriting the bond but that interest, over time, is going to the bondholders and not back to the banks. In a synthetic fixed-rate structure, the interest that's going to go to bondholders is much, much lower and the rest of the money is actually going to the banks.

The reason why they push you into these structures that have more complex transactions and more individual deals built into them is that with each of these deals, banks get to charge fees and collect more of that money for themselves instead of it going to bondholders or anywhere else. That's the piece that's often lost on public officials, is that no, the bank is not looking to do you a favor. They're looking to maximize their own profits and, ultimately, those profits are coming at the expense of taxpayers.

OK, so how do people end up experiencing this in their everyday lives? Obviously no one wants to see their tax dollars wasted, but that's a somewhat abstract transaction — a few numbers on your monthly check or what have you. How does it become more tangible, the downside?

I think it has a huge impact. For example, the Detroit Water Department in 2012 had to pay $547 million in penalties to terminate interest rate swaps. Now more than 40 percent of the water bill that people pay in Detroit actually goes towards paying off that termination fee, and it's hit the Water Department hard so now the Water Department is actually shutting off the water of Detroiters who have missed just a couple of payments on their bill. In the meantime, they're actually paying out $547 million in fees to banks on these deals.

There is strong reason to believe that if the Detroit Water Department pursued legal claims against the deals that they could have recovered some of that money, but instead of trying to recover the

$547 million they're turning off the water on low-income, working-class people of color who are already struggling to get by.

In Chicago we've seen the impact of these finance deals in school closings. in Chicago we had the largest school closing in the history of the country when 50 schools were closed last year, presumably to save money. Based on CPS' own estimates, each school closing would have saved up to about $800,000, and in the meantime the school system is paying out $36 million a year on its interest rate swaps. The Tribune estimated that this complex financing structure with auction rate securities is going to end up costing the school system $100 million more than if it had chosen a fixed-rate traditional bond, and that's actually a conservative estimate because it only looks at a small number of the deals that CPS has.

You mentioned before that municipal officials have more control over this situation than they either think or want us to believe. What are some of the tools they could be using?

There's a couple. There are some legal angles here, which is that for many of the deals that have taken place there have been a clear law-breaking risk. That's a case with things like the illegal manipulation of the LIBOR interest rates, that's happened with the way a lot of these auction rate securities and interest rate swaps were pitched and the risks misrepresented. There are some clear legal angles there, you can file for an arbitration with the Financial Industry Regulatory Authority under the Fair Dealing Standards of the Municipal Securities Ruling Board. You can also sue for state-based claims for breach of contract and fraud, where applicable.

Beyond that, there's some bigger stuff overall, which is just not done very often. Cities and states could actually play hardball with Wall Street. In reality, there are a lot of different fee structures, deal structures, that exist only because they're not really pushed back on, ever. For example, bond underwriting fees are typically a percentage of the total amount that's being issued, but in reality it's not any more work for a bank to underwrite a $200 million bond than it is to underwrite a $100 million bond and they get to make twice as much money. There's no reason why that's the case; there's no reason why it's a percentage, but if any one city were to try to buck that trend, they would say, "That's just not how it works."

The reality is that the market is not preordained. Right now, Wall Street sets the terms of the market and cities and states negotiate around the margins. What we need is to turn that on its head. If we actually had cities and states saying, "Here are the rules that we're going to operate by because this is what works for taxpayers," and Wall Street can take it or leave it, if they actually stand by that they can move the market. American taxpayer dollars are still one of the largest pools of capital that exist in the country, in the world.

The city of Los Angeles currently has a campaign where they're trying to reduce their fees. The city of Los Angeles is the second-largest city in the country. It also has a huge pension fund and many different agencies that it controls. If you actually have the city of Los Angeles take a hard line that says, "We won't do business with any banks that don't abide by this set of rules or that don't put the interests of taxpayers first," then they can actually change the way Wall Street deals with them. If you have enough cities getting together and saying they'll do that, that can have an impact.

In 2012 the Oakland city council managed to pass a resolution to boycott Goldman Sachs because they wouldn't renegotiate an interest rate swap. The city of Oakland by itself is relatively small, but if you had Oakland, Los Angeles, Chicago, Chicago Public Schools, New York, the New York Metropolitan Transportation Authority, all of these different bodies with interest swaps, if they were to pass similar resolutions they could renegotiate these interest rate swaps in a heartbeat. There's this power of numbers and we need cities and states to more effectively use their leverage as

customers of Wall Street to renegotiate our relationship.

The report has a few recommendations for how government officials and citizens can address this problem. What are they?

One is that we need greater transparency around the financial health of our cities; we need to know how much money we're paying out every year on financial years, and we need greater transparency in terms of the deals that we've entered into and the risks that are contained within them.

Secondly, we need accountability … [if] we learn that the banks have broken the law, we need to actually litigate against them and get back the money they've taken from us. We need to hold them accountable, and then even where there is not illegal behavior, but there is unethical behavior, we need to use our leverage as customers of Wall Street to hold them accountable and try to get a better deal.

Thirdly, we need to try to reduce fees, again using our leverage as customers of Wall Street.

The fourth recommendation is something I call "collective bargaining with Wall Street," which is the idea of having cities and states across the country band together and try to change the conditions and terms that Wall Street operates under to better reflect the interests of taxpayers.

Fifth is creating more public options for financial services. There are many types of financial services like investment management or debt management that cities and states could do themselves for cheaper and they need to start thinking about developing those capacities.

Finally, the last recommendation of the report is to create publicly owned banks. We currently have one of these in the U.S., which is the Bank of North Dakota, and we need to look at the option of creating more publicly owned banks either at the city, state or county levels.

Say you're a voter who cares about this issue but isn't really so wonky and numerically inclined. What are some red flags or good signs, in terms of rhetoric, that people should be paying attention to when they're deciding whom to support in local government?

Any politician who says, "All of our deals are fine" — that should be a red flag. Anyone who says, "We're sophisticated and we know what we're doing" — that should be a red flag. Anyone who tries to obscure what's going on by muddling it in complexity, to make it hard to understand — that should be a red flag. What we should be looking for is people who can actually talk about this in a way that makes sense.

One of the tricks Wall Street has when it comes to municipal finance and when it comes to finance more generally is to make things seem overly complex, so complex that people stop caring and believe they can't possibly understand it. That's not actually the case. In reality, most of these things can be understood and can be talked about in plain English, and what we really need is more elected leaders who are willing to break these things down and talk to voters about them in a way that they can understand and that can offer real, common-sense solutions that don't take a finance degree to understand. At the end of the day, this stuff does not need to be so complicated. Anyone who's promising another complicated financing scheme as a solution is probably not actually going to be able to deliver on that because the more complex you get, the more heavily weighted things are in the banks' favor.

The key words we should be looking for from politicians is that we shouldn't need key words. They should just be able to talk about solutions that actually make sense to the average person and make it clear that they're actually going to hold banks accountable for these deals they've already gotten

into and make sure we're having good, plain, vanilla banking going forward that will make sure we get the best deals.

SALON.COM

MONDAY, NOV 24, 2014 05:30 AM PST

ELIAS ISQUITH

Elias Isquith is a staff writer at Salon, focusing on politics. Follow him on Twitter at @eliasisquith, and email him at eisquith@salon.com.

Stockton Highlights Nationwide Risk of Conflict Between Muni Investors And Public Sector Unions.

Fixed-income investors are now on notice that their rights could be trumped by public-sector union bosses, following a court ruling granting Franklin Templeton Investments just pennies on the dollar for its muni bonds from bankrupt Stockton, California. And the case is only one of many across the country. (There's no word yet on whether Templeton will appeal.)

The ruling, while distressing, should not be surprising. In part, because investors are subject to an unfair information asymmetry at the hands of state and local governments. It's well-documented that government pensions tend to understate their pension and other obligations to workers and retirees, potentially hiding some risk from bondholders.

Yet, it's not all bad news for investors. While this most recent ruling clearly favored public employees over investors, in an earlier ruling the same judge made history in the Golden State by designating pensions as impairable—subject to a haircut in the event of bankruptcy. Pensions may still get favorable treatment, but no longer in automatic fashion.

Stockton is not alone. A new report from Moody's Investors Service shows just how widespread the risk runs as investors weigh whether to put their trust in municipal officials. The question is whether Stockton could be a wake-up call for city managers and union leaders across the country to tighten their belts and lower the temperature at the negotiating table.

"When municipal credit deteriorates to the point of service insolvency and results in bankruptcy or receivership, bondholders can find themselves in fierce competition with pensioners and current employees over resources and priority of payment," wrote my former colleague Al Medioli, vice president and senior credit officer at Moody's.

In my former life as municipal bond analyst with Moody's (I rated hospitals that behave like businesses in many ways but receive the tax benefits of a not-for-profit and thus fall under the muni umbrella), one of the factors we considered was whether a debt-issuing entity was unionized, a status that was inherently viewed as a "credit negative" due to unions' ability to disrupt operations. When we observed a history of obstreperous union leadership, we noted this to investors.

"Despite this decision to confirm Stockton's plan leaving pensions intact, local governments will now have more negotiating leverage with labor unions, who cannot count on pensions as ironclad obligations, even in bankruptcy," Moody's wrote in another report after the ruling.

This will also help cities better with Other Post-Employment Benefits (OPEBs), which typically include life insurance, health care benefits, and deferred-compensation. In the Stockton bankruptcy, only 1 percent of OPEBs were recovered. During restructurings, OPEBs are often used as a bargaining chip to cash in favor of pension protections. And as with pension obligations; oftentimes the OPEB obligations are obscured. The sheer irregularity of such an arrangement and the politicization of these benefits will no doubt be red flags to potential bondholders as they choose where to invest in the future.

Medioli's report examined the seven substantial municipal restructurings that have occurred since 2008. Of the seven, just one (Central Falls, Rhode Island, where bonded debt made up a small fraction of liabilities) took a haircut on pensions while making investors whole. The other five (San Bernadino, California, is still pending) favored pensions: four paid 100 percent to their pension funds while skimming from investors. Detroit was ordered to pay 82 percent for pensioners and only 25 percent to investors.

Such thumb-on-the-scale restructurings in favor of union leaders creates economic moral hazard: City stewards are less likely to enact urgently needed pension reforms if they know accountability is unlikely. Workers and retirees put their hard-earned money into pension systems and are understandably anxious to enjoy the fruit of their labors. Yet cities that make unsustainable defined benefit promises do a disservice to their workers. Some muni bond issuers have shifted to a hybrid model with features of a 401(k)-type defined contribution structure with some guaranteed contributions. This is more sustainable for both taxpayers and workers.

"Reality is not negotiable," former Utah state Sen. Dan Liljenquist, a Republican who helped push a hybrid model in his state, told The Wall Street Journal. "The fact is somebody bears the risk. Ultimately, the state is bearing more risk than it can."

Forbes.com

Carrie Sheffield | Contributor

11/17/2014 @ 10:11PM

GASB: On the Horizon.

Accounting for Leases

After completing the initial phase of project deliberations, the GASB is preparing to issue a Preliminary Views for its Leases project in November. A Preliminary Views is a document the GASB issues to gather public input on a topic prior to proposing new standards. This document will lay out the Board's initial thinking on how to improve the GASB's current accounting and financial reporting guidance on leasing.

The existing GASB guidance on lease accounting is based on Financial Accounting Standards Board's (FASB) guidance issued through 1989. The GASB routinely evaluates its standards to ensure that they continue to properly capture the transactions they address and to result in information needed to make decisions and assess accountability. Because the FASB has an active lease accounting project underway, it was an opportune time for the GASB to look at its existing lease accounting standards and leverage off of the FASB's efforts, while considering the government environment.

The GASB's forthcoming proposal is intended to provide essential information to financial statement users and to reduce complexity for preparers, thereby enhancing the overall effectiveness of the Board's guidance on leases.

The Preliminary Views document will address how leases are presented in the financial statements and the basic information that lessee and lessor governments should disclose in the notes. In addition, the due process document will address topics including:

- The definition of a lease
- Separating components of contracts that contain lease and service provisions
- Lessee accounting, including note disclosures
- Lessor accounting, including note disclosures
- Short-term leases
- Sale-leasebacks
- Intra-entity leases.

View an article on the Leases project from a previous issue of the GASB Outlook.

Fiduciary Responsibilities

The GASB is finalizing a Preliminary Views for its Fiduciary Responsibilities project. The document is expected to be issued in November.

The GASB is planning to propose guidance addressing when a government would have a fiduciary responsibility. Fiduciary responsibility generally relates to acting as a guardian or trustee of assets belonging to others. The Board's primary objective is to enhance the consistency and comparability of when and how governments report their fiduciary activities in audited financial reports. To meet this objective, the document will:

- Define when a government has a fiduciary responsibility and, therefore, is required to present fiduciary fund financial statements
- Define the types of fiduciary funds
- Clarify financial reporting requirements for business-type activities that have fiduciary responsibilities
- Introduce the use of a financial statement that reports the inflows and outflows of resources for all fiduciary fund types.

View an article on the Fiduciary Activities project from a previous issue of the GASB Outlook.

Other Postemployment Benefits

In November, the GASB is scheduled to begin redeliberations on the two Exposure Drafts issued in connection with the Other Postemployment Benefits (OPEB) project and the related Exposure Draft on pensions, in light of the public response to the proposals.

The GASB received written comments from 76 individuals and organizations in response to Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions. Thirty individuals and organizations commented on Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, and 26 commented on the Exposure Draft addressing pension-related issues.

More than three dozen stakeholders provided the Board with additional input and feedback in a series of public hearings held in September in New York, Chicago, and San Francisco. The Board

also reviewed results of field testing of the proposed OPEB standards at various state and local governments.

View an article on the OPEB project from a previous issue of the GASB Outlook.

External Investment Pools

The GASB recently commenced pre-agenda research on external investment pools that function, for governments, much like money market funds do in the private sector. The GASB will study what effects, if any, changes recently adopted by the Securities and Exchange Commission (SEC) will have on external investment pools operated by governments.

The research will provide the GASB with the information it needs to determine whether a project should be added to the current technical agenda to consider revising existing standards on external investment pools. Initial research will explore the degree to which government investment pools conform to or diverge from the current and new SEC rules.

The staff is scheduled to provide an educational memo with research findings to the Board before the end of 2014.

Detroit Bankruptcy 'All Negative' For Muni Investors – MMA.

I spent my Current Yield column this week discussing how the outcomes of the Detroit and Stockton bankruptcies are pretty uniformly bad for muni bond investors, since both of those cases upended the preferential treatment bondholders have traditionally received in Chapter 9 cases compared with other creditors. Instead, bondholders got the short end of the repayment stick in both cases, as public employees and pensions recovered a lot more of what each city owed them than bondholders did.

The outcome of the Detroit case was so bad that it prompted Matt Fabian of Municipal Market Advisors today to label the situation "all negative" for muni investors, particularly in the state of Michigan, adding that "takeaways for the municipal market from Detroit's bankruptcy are uniformly negative."

Fabian offers his own version of Bank of America Merrill Lynch's seven lessons for investors from Detroit's bankruptcy. Here's a brief version:

- **Pensions > Bonds:** "In the absence of legal precedents to the contrary, local unsecured GO bondholders, particularly those in MI, have to assume their position in the capital structure is subordinate to pensioners and indeed that of almost any other politically connected creditor," Fabian writes. That's some serious food for thought if you own muni bonds in Michigan.
- **OPEBs = Bonds:** Fabian points out that unsecured bondholders weren't treated better than OPEBs, which he calls "a complete change in thinking" for the muni market.
- **Secured credits got impaired too:** Fabian says Detroit represented "the largest municipal payment default in recent history" for secured creditors, despite the allegedly superior investor protections afforded secured creditors.
- **Bondholders can be bullied:** After this case, Fabian sees "no reason why future debtor advisors would not similarly be able to harass municipal creditors into large losses."
- **State as adversary, not partner:** Fabian says Michigan "played a key role in steering losses onto" bondholders, and that lower-rated government bonds in Michigan "may no longer be suitable

for traditional retail investors."
- **Investor ambivalence:** Fabian says investors have continued to buy Michigan bonds, and underwriters have continued to issue them, with little negative consequence to the state despite the unfavorable treatment of Detroit bondholders.

Fabian adds that Detroit still needs revenue growth to make its bankruptcy-exit plan work, and he calls the court case "undeniably a success for Detroit's restructuring advisors, who followed a corporate-style, adversarial strategy that set creditor losses as its highest priority" and in doing so set a precedent for future municipal bankruptcy cases. He says the outcome may even prompt more federal scrutiny of profligate municipal governments, saying it even incrementally increases the risk that the federal government might revoke the tax-exempt status of municipal bonds.

As for Stockton, Fabian says the unfavorable treatment of certificates of participation in that case "should incrementally reduce the value and liquidity of [California] COPs." He adds that COPs have been an important financing structure for California local governments, which are "likely to see their borrowing costs rise as a result."

November 10, 2014, 2:58 P.M. ET

By Michael Aneiro

Barron's

S&P's Public Finance Podcast (California's Proposition 2, Stockton, And Detroit).

From Standard & Poor's CreditMatters TV:

Extra Credit: S&P's Public Finance Podcast (California's Proposition 2, Stockton, And Detroit)

Watch here.

State Pension Funds' Combined Underfunding Rises to $4.7 Trillion — Report.

State employee retirement systems are underfunded by a total of $4.7 trillion for a funding ratio of 36%, said a report from State Budget Solutions, a non-profit organization advocating state budget reform.

The report, "Promises Made, Promises Broken 2014" uses data from fiscal year 2013 comprehensive annual financial reports and actuarial valuations from individual plans. In its 2013 report, the group estimated underfunding at $4.1 trillion, or a 39% funding ratio.

The report measured state public pension liabilities by market valuation instead of discount rates based on investment return assumptions because "the discount rates that plans use are just far too high," said Joe Luppino-Esposito, State Budget Solutions general counsel and the report's author, in an interview. A risk-free rate based on a 15-year Treasury bond rate works better when states fail to make annual contributions and address unfunded liabilities, Mr. Luppino-Esposito said. "Even if you

are on target, it doesn't work. The bottom line is that on paper nothing beats a government pension. But in reality, the money isn't there," Mr. Luppino-Esposito said.

The overall actuarial assets of state pension funds in the 50 states, according to the report, total $2.68 trillion, while liabilities total $7.42 trillion.

Using the states' own assumptions, unfunded liabilities are just over $1 trillion, the report said.

The state with the lowest funding ratio is Illinois at 22%, the report said. The state's public employee pension funds have $95 billion in assets and $426.6 billion in liabilities, according to the report.

PENSIONS & INVESTMENTS

BY HAZEL BRADFORD | NOVEMBER 12, 2014 2:25 PM

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

S&P: U.S. Public Finance Rating Improvement Cools in the Third Quarter After the Local Government Criteria Implementation Period.

U.S. public finance (USPF) upgrades again outnumbered downgrades during the third quarter, but the upgrade-to-downgrade ratio continues to decline. The slower pace of upgrades reflected, in part, Standard & Poor's Ratings Services completing its implementation of its revised local government general obligation (GO) bond rating criteria during the third quarter. The revised criteria resulted in upward revisions of approximately 41% of our local government ratings. Through the 12-month criteria implementation period, our upgrade ratio reflected this transition to a higher local government ratings distribution.

As the criteria implementation began to wind down, the upgrade-to-downgrade ratio declined in step with the decrease in criteria-related rating actions. The 2.18 to one upgrade to downgrade ratio during the third quarter was lower than in any other period since the second quarter of 2013 — just before the introduction of our revised local government criteria.

Continue Reading.

10-Nov-2014

MMA Municipal Issuer Brief - Green Bonds.

Municipal Market Advisors Municipal Issuer Brief – November 11, 2014

Why Pay for Success Matters.

For too long, public funding has been extended toward programs that show little efficacy or impact in areas they target. And yet, year after year, these programs continue to get funded.

But there are some encouraging developments as new models have begun to take shape in communities across our nation and around the world that offer the promise of delivering more effective and efficient services to citizens at a reduced cost by government. One approach that has gained increasing traction is known as Pay for Success – programs that rely on defining real outcomes and using data and evidence to measure progress.

This model has appeal to taxpayers, governments, philanthropy and the private sector because it represents a unique partnership model that infuses private sector resources to fund evidence-based interventions in areas ranging from education to healthcare to unemployment. Funding takes place at the front end of program delivery and requires government to pay for services only when outcomes are delivered. If outcomes aren't achieved, the government can pay nothing; if outcomes are achieved above a certain threshold, private sector investors don't just get their money back, they may see a return on top of the amount originally invested.

Emphasis on best practices and evidence-based programs

While the idea of evidence or outcomes-based funding shouldn't seem radical, the reality is that in too many publicly funded programs, there is little or no data to determine if investments are yielding intended results. By introducing a model for funding that can infuse new private sector capital at the outset, a much more rigorous measurement process is put in place and the government only pays when outcomes are achieved. These new models hold the potential to illuminate what works and what doesn't, and to optimize both delivery of service and tax dollars.

The blended approach

Another attractive feature of pay for success models is the "blended" approach the funding mechanisms can represent. While private capital is put up at the front end of a program by means of a bond as an investment tool, often philanthropy will underwrite any "first losses" – in other words, limiting potential investor losses, should the program not show desired outcomes. This dramatically reduces the risk for private sector investors, while maintaining the potential upside for investors should the program yield results.

Why would philanthropy cover potential losses? In philanthropy, most giving represents 100% permanent loss of capital – you write a check for a donation and funds are expended and taken off the books. With pay for performance, these underwriting "guarantees" are only called if the program fails to achieve targets. So philanthropists may never need to actually expend funds if the program is successful. Additionally, this "catalyst" style of potential funding unleashes and infuses new private capital into social programs, augmenting and scaling what philanthropy and governments typically fund. Taxpayer dollars are made most efficient since the model only requires government expenditures for successful outcomes, thus eliminating waste.

The Pay for Success model is not without its critics – some say it's simply too good to be true, some believe that it's impossible to put this model into practice, and others say that we simply don't have enough evidence to show that this approach works. But others believe it could well represent a new way forward as the needs of our communities grow and government resources continue to come under pressure.

Like any innovation, Pay for Success will likely have both victories and failures. We're certainly encouraged by reports like this week's from the Beeck Center for Social Impact and Innovation at Georgetown University and Monitor Deloitte, which provides case studies and success stories from around the world to help policy makers design programs that achieve real impact.

We are also pleased to see policymakers like U.S. Representatives John Delaney and Todd Young taking the lead on bipartisan legislation like the Social Impact Bond Act, which would foster the creation of programs that incentivize results, not just activities. We're also watching state and local officials like Mayor Ben McAdams of Salt Lake County, who is financing quality early childhood education through a Pay for Success initiative in partnership with Goldman Sachs.

It's early days for pay for success models, but these and other innovative approaches to funding needs in our nation and around the world hold promise for an improved "invest in what works" approach that delivers better practices and outcomes for those being served.

FORBES

Jean Case Contributor

11/13/2014 @ 8:30AM

California's New Tax Increment Financing Law Could Unlock Billions of Dollars.

When California Gov. Jerry Brown signed a new law on Sept. 29 to facilitate infrastructure financing, he gave hope to people in the Golden State and beyond that local governments would pick up where constrained state and federal budgets have failed to meet enormous needs for road, transit, water, sewer and many other projects.

The law, S.B. 628, is expected to revitalize the practice of tax-increment financing in California—a means of generating revenue based on projections of higher property values and taxes arising from long-term property development following in the wake of infrastructure construction. It lowers voter-approval thresholds and expands the range of infrastructure projects eligible for support. If communities embrace the new statute, billions of dollars in new financing will become available.

Last year, the American Society of Civil Engineers estimated U.S. infrastructure funding needs of $3.6 trillion through the end of the decade, with funding streams expected to produce only $2 trillion. Another study, just released by the International Monetary Fund reports that infrastructure quality in the United States has been declining since 2006, and now ranks behind that of other major countries: Germany, France, Japan, Canada and the United Kingdom. The study asserts that the time is right for a major infrastructure push.

In this country, "the national consensus on infrastructure has broken and a new framework, and new institutional arrangements, are needed," says Mark Pisano, a professor of the practice of public administration at the University of Southern California and a force behind the new state law.

Congress has not seen fit to increase the 18.4 cents-per-gallon gas tax that's been on the books for year, instead funding the national highway "trust fund" with stop-gap gimmicks that expire in May. Water, sewer and other infrastructure needs are also underfunded, according to the civil engineers.

The prospect that California's new law may have the breadth to address many local infrastructure needs is seen in West Sacramento, just across the river from the state's capital city. It is one of just two or three jurisdictions in the state that is on the road, albeit under an older statute, to successful use of forward-looking tax increment financing, or TIF.

This, as a Las Vegas craps player might say, involves betting on the come: counting on revenues that will accrue from private investment that follows development of high-quality infrastructure in new or redeveloped areas. Tax increment bonding under the new law allows jurisdictions to look out 45 years as they project new building and consequent new property tax revenues.

West Sacramento's Bridge District, once a crumbling, decrepit industrial area, is now benefitting from rapid revitalization thanks to such financing techniques. A major boost to the area came in 2000, when a new ballpark, Raley Field opened as home to the Sacramento River Cats, Triple-A affiliate of baseball's World Series champion San Francisco Giants. After much work to deindustrialize the rest of the Bridge District, housing and retail are coming on line.

Financing Techniques Evolve

The heyday of California tax-increment financing came during the first decade of this century, when state law allowed cities to create "urban redevelopment zones." To fund investment in blighted areas, the zones could collect part (an "increment") of assumed property tax growth. This, of course, deprived the cities themselves of revenues they might need to finance their operations, and the broad law also allowed increments to be collected against other municipal entities, notably school districts and community colleges.

West Sacramento's redevelopment zone covered 45 percent of the city and generated $60 million, or about $5 million a year, to fund infrastructure from 2000 to 2012. But then the state government rescinded redevelopment zone authority. In a wrenching state budget crisis, the governor and legislature decided they could ill afford to continue backfilling school budgets for the revenues they'd lost to the redevelopment zones.

West Sacramento acted to ensure that remaining redevelopment tax funds would remain available. The Bridge District was already deep into its revitalization program. Highways had been torn down, rail lines removed, and blighted areas cleaned. Apartment complexes were under construction. But much more infrastructure was needed to achieve the vision of a dynamic community, with parks, public spaces and a reclaimed riverfront.

So the city and its economic development manager, Aaron Laurel, decided to employ another legislative authority to create Increment Financing Districts, or IFDs. This law, which has now been replaced by S.B. 628, required a two-thirds vote of property owners in the district, both to create the district and then, in another vote, to authorize issuance of bonds. These were high hurdles and West Sacramento's was one of few significant initiatives that met them.

The other, in San Francisco's Rincon Hill, is clearing blight and creating new living opportunities near the base of the San Francisco-Oakland Bay Bridge and not far from AT&T Park and the Embarcadero.

With most renewal projects stalled, urban infrastructure experts began a drive to enact the new TIF law that would be easier for communities to use. California Forward, a foundation-supported government reform organization whose board has included many prominent citizens, was among leaders of the effort.

Pisano, who served as the executive director of the Southern California Association of Governments for 31 years before his professorship at USC's Price School of Public Policy (pictured here), worked with California Forward fiscal policy expert Fred Silva, in drafting language and later writing a guide to using the new authorities.

The new law includes major departures from past practice:

- Communities can now establish “enhanced” IFDs without a vote.
- A vote is still required to create bonding authority but now just 55 percent of ownership approval is needed, down from 67 percent.
- IFDs can now look out as far as 45 years when calculating increases in property values, allowing much larger valuations than under the present 30-year limit.
- Unlike bonding under the old redevelopment authority, funds can be used both inside and outside the financing district—for example to build two new bridges and a streetcar line running across an existing bridge between West Sacramento to downtown Sacramento.

In addition the new law will allow a broader range of infrastructure needs—roads, transit, bridges, water, sewer and other underground utilities, cleaning of brownfields, parks and more.

The 45-year term “is a really big deal,” says Laurel, observing that adding 15 years of assumed development will allow substantially larger bonding authority—likely more than offsetting the loss of authority to include school district revenues in the increment financing plan. Parks in the Bridge District are high on his priority list.

As his bill, S.B. 628, was approved by the legislature, State Sen. Jim Beall, a Democrat from San Jose, says it would “help local jurisdictions finance transportation projects and transit-oriented development.’’ He noted the large funding gaps local leaders face as they try to make investments in everything from aging water mains and crumbling local roads to next-generation transit stations. In Los Angeles alone, for example, the nation’s second-largest city is estimated to have a backlog of $8.1 billion in deferred infrastructure maintenance—a figure as large as the city’s entire annual budget, reports California Forward staffer Justin Ewers.

Pisano, during a recent meeting of a National Academy of Public Administration infrastructure task force he chairs, observed that billions of dollars in private funds are “looking for a place to land” in financing infrastructure projects. Private highways and bridges are showing the way, but additional novel institutional arrangements are needed to boost further progress.

California’s new law should encourage more public-private partnerships, Pisano says, and in this and other regards may contribute to a new vision for building infrastructure and revitalizing the U.S. economy.

Government Executive

By Timothy B. Clark

November 11, 2014

Timothy B. Clark is editor-at-large at Government Executive.

A Green Bond for Public Pensions.

Pension plans want to support environmental projects, but there is one thing holding them back.

Green investments are the current darling of Wall Street. The market for them is expected to exceed $40 billion this year, according to Bloomberg. But there’s one huge institutional player who’s being

left out: state and local pension plans.

“There has been a lot of buzz about infrastructure finance in the public pension community,” said Girard Miller, chief investment officer of the Orange County Employees Retirement System (OCERS) and a former Governing columnist. He noted that many pension plans are interested in investments that can boost funding for new infrastructure, especially when those projects are environmentally friendly. The problem, Miller said, is that pension investment officials “don’t want tax-exempt paper in their portfolios.”

Why? Since pension plans are already tax exempt, they can’t claim the tax exemption. That leaves, he says, “a mismatch between available pension capital and the public sector’s infrastructure financing needs, especially for projects that lack a revenue source.”

Is there a fix? Miller talked about one in a recent interview, which has been edited for clarity and length.

Let’s start at the beginning. There are so many definitions of green bonds out there. How are you defining it?

These are bonds issued to finance environmentally friendly capital projects. One use of the concept applies very narrowly to tax-exempt bonds for what are called brownfields development. Then there is also an international working group promoting “climate bonds,” which are sometimes called green bonds. CalSTRS, the large state teachers pension fund here in California, is part of that working group. The central idea is to reduce the carbon footprint globally through infrastructure projects that can be funded through big bond issues. I use the term green bonds very broadly to include essential environmental projects that might be funded by states and localities through bond financing. Beyond carbon reduction and water conservation in drought areas, I’ll leave it to the policy geeks and public finance guys to haggle over the definition. It’s a big tent.

When Connecticut issued a green bond this past October, State Treasurer Denise Nappier said they were developing the bonds “to meet the needs of the growing group of investors who have mandates to invest in sustainable projects that will help preserve our environment for future generations.” Where do pension plans fall within this “mandate”?

In OCERS there isn’t a mandate, no social objective. The traditional goal is to seek out the best returns. There are other, bigger funds that take a broader view of their responsibility. The word that strikes me as interesting was coined by John Rogers, the past president of the Chartered Financial Analyst Institute: super fiduciaries. These are big funds — like CalPERS or CalSTRS — that take large positions so that they own a chunk of the economy. For them, terms like sustainability mean something because if society at large fails -— especially in terms of environmental concerns — then their overall investments are not going to do well. They feel they have a higher calling than squeezing out the best profit. That’s where some of the pension plan interest in green bonds comes.

The problem is that pension plans don’t want tax-exempt income. We’re not the only ones. Sovereign investment funds from abroad, such as those in China and the Middle East, and endowment funds don’t care about taxes either.

What would attract them?

What we need is a taxable option to be approved by Congress and limited to green bonds, not to every conceivable capital project, which is typically what happens when politics gets involved. A taxable bond option (TBO) is a concept that has been kicking around in public finance circles for four

decades. As far back as the 1970s, economists like John Petersen were saying there is a smarter way to do this stuff. Build America Bonds, which were authorized in 2009-2010 at the bottom of the Great Recession, were a taxable option. A TBO allows, but does not require, a muni bond issuer to elect to pay taxable interest and receive a direct interest-cost reimbursement from the U.S. Treasury rather than the indirect subsidy of tax exemption. In most cases, that would mean a lower borrowing cost — net-net — than issuing tax-exempt bonds. For pension plans, a TBO-yield will compare favorably with corporate credit and foreign sovereign bonds, plus the bonds would be a diversifier for our bond portfolios. Foreign investors and endowment funds, as well as ordinary investors with incomes below $200,000, would prefer taxable municipals.

What's the objection to them?

Some leaders in the public finance community believe that it's a slippery slope, that if the federal government starts down this path they will someday want to eliminate tax exemption for municipal bonds. Secondly, there has been a fear in some circles that someday the feds will run out of money and renege on their promise to pay the interest reimbursement. In theory, it's harder to renege on tax exemption.

What's the track record with Build America Bonds? Did the federal government keep its commitment? Did the bonds sell well?

Build America Bonds were successful. No one disputes that. It was limited in term, and the bonds got scarfed up and are sitting in people's portfolios. Uncle Sam is paying its share and there's no sign of doing anything otherwise.

What's the U.S. government's interest in a taxable muni?

It costs the Treasury less to pay a direct subsidy to the muni bond issuer than to give a tax exemption to the typically wealthy investors whose effective marginal income tax rates are usually 28 to 40 percent. For state governments, the taxable option could help their revenues as well. It works as long as the reimbursement rate of the direct subsidy is lower than the effective average tax rate on that issuer's muni bonds.

So what's the next step?

The public finance community, the public pension funds and their lobbyists on Capitol Hill have to step up to make this happen.

GOVERNING.COM

BY PENELOPE LEMOV | NOVEMBER 13, 2014

plemov@governing.com

Market Rates of Return for Effective Financial Management.

The Pioneer Institute released a report this week that provided more evidence to conservative groups who say that U.S. pensions are over-valued. Most pension funds calculate their assets and unfunded liabilities using an assumed rate of investment return between 7 and 8 percent. The Pioneer Institute advocated using a market rate. Its report outlined how to create a rate of return for

each individual plan based on the historical returns of each investment asset type. For example, for a portfolio with a mix of investments ranging from stocks, which historically average an 8.3 percent return rate, to real estate assets, which average a 3.4 percent rate of return, Pioneer would assume a rate of return around 6.6 percent.

With pension accounting changes being rolled out everywhere this year, the institute's paper provided a glimpse into what changes may be in store for many plans. In one of the starkest examples, the unfunded liability of the Illinois State Teachers Retirement fund, which assumes an 8 percent investment return, would increase by more than one-third to nearly $79 billion, according to the Pioneer Institute. (The institute's formula yielded a 6.3 percent investment return for the teachers' fund.)

Moody's: More Than Half of Largest US Cities Maintained or Improved Credit Quality Since the Recession.

New York, November 13, 2014 — Since the onset of the Great Recession, the credit quality of 34 of the 50 largest US cities was either maintained or improved, says Moody's Investors Service. In the report "Anatomy of Successful US Cities," Moody's attributes the resiliency of these cities to their inherent strengths and robust financial management.

"By no means were these successful cities immune to the downturn, but the impact was much less severe, especially with the support of healthy tax base growth," says Jennifer Diercksen, a Moody's Analyst. "Other supporting factors were tax base diversity, a significant institutional presence, and their status as regional economic centers."

Despite the challenges of the downturn, the tax bases of the 34 successful cities increased by 6.6% on since 2008, compared with a median decline of 3.6% for all US cities with populations over 100,000.

Furthermore, the successful cities have very diverse tax bases, reducing the exposure of governments to one particular industry or large taxpayer. In addition, the stable presence of large institutions, such as federal government agencies, universities, and hospitals, benefits these cities by offsetting negative credit forces.

With healthy tax base growth, the successful cities effectively balanced their budgets, increasing revenues by 7.7% and expenditures by 7.0% between 2008 and 2013. In contrast, other US cities with populations over 100,000 saw average revenue growth of 2.0% and expenditure growth of 2.8% over the same period. The successful cities ultimately improved their reserves, which averaged 18.6% of operating revenues in fiscal 2013.

Furthermore, while these successful cities had above-average debt burdens, they were often the result of addressing the capital needs of large city infrastructure. Fixed costs, including debt service, pensions and OPEB, still remained manageable, providing these cities with budgetary flexibility.

Thirty of the 34 successful cities maintained their ratings throughout the recession, while four experienced rating upgrades. Overall, the successful cities maintain a median rating of Aa1, two notches above the sector median of Aa3.

Moody's subscribers can access this report here.

Moody's: Most US State Retiree Health Care Costs Becoming More Affordable.

New York, November 10, 2014 — Many states have largely stabilized their retiree health care expenses through a combination of benefit changes and moderating health insurance costs, but these liabilities remain high for some states — particularly those that fully pay for teacher benefits. Retiree health care, also known as other post-employment benefits (OPEB), for states is fully explored in the new Moody's Investors Service report, "States Controlling Retiree Health Costs, but Teacher Benefits Are Costly for Some."

Thirty-one states have been able to lower or maintain OPEB costs relative to revenue since 2011 by adjusting healthcare benefits and aided by low price inflation. Overall, the majority of states are seeing stable to improving OPEB affordability, with median OPEB costs under 1% of revenues from fiscal years 2011 to 2013. Most states pay for retiree health costs on a pay-as-you-go basis, rather than putting money aside now for the benefits that current employees will receive when they retire.

"Unlike pension benefits, OPEB liabilities are not contractually protected in most states," says Marcia Van Wagner, a Moody's Vice President and Senior Analyst. "This allows government employers to control costs by adjusting health benefits and employee or retiree contribution requirements."

Changes to benefits and other factors also have reduced total state OPEB liabilities, which measures in present value terms all the retiree health benefits that current employees and retirees would receive given plan benefits. OPEB liabilities fell 7.5% from 2011 to 2013. Some states were able to reduce OPEB liabilities by a much greater amount. Ohio, whose costs declined the most, changed eligibility provisions for covering spouses, children, and benefits for Medicare-eligible retirees. Kentucky raised the level of contributions required of active employees toward their retiree health benefits. Some states also changed the vesting periods for eligibility for retiree health insurance.

Provisions in the Affordable Care Act (ACA) have also allowed states to change the way they account for future OPEB liabilities. The ACA has allowed states to shift pharmacy costs to Medicare and raise drug subsidy discount rates, thereby pre-funding a portion of future liabilities.

Furthermore, average insurance premiums and total national health expenditures have moderated along with medical care inflation, allowing states to lower cost trend assumptions in their OPEB valuations.

However, states that fully or partially pay for teacher retiree health benefits continue to have greater OPEB debt burdens. Five states with the highest OPEB liabilities — Connecticut, New Jersey, Illinois, Hawaii, and Delaware — fall into this category. Many of these states also have high debt and pension costs for the same reason.

Containing costs will be more difficult for states with less flexibility to adjust OPEB benefits as the aging state workforce retires. The small number of states whose laws protect OPEB benefits will be most challenged, but states that pre-fund liabilities will face budgetary pressure during periods of low-to-moderate revenue growth.

Moody's subscribers can access this report here.

Muni Supply Set to Shrink as Redemptions Exceed Sales.

The U.S. municipal bond market is poised to contract in the next month as redemptions and maturing debt exceed sales of new securities.

The gap between redemptions and new debt, a signal of supply and demand in the $3.5 trillion municipal market, will reach $27.3 billion over the next 30 days, compared with a contraction of $4.74 billion last month, according to data compiled by Bloomberg.

States and localities have scheduled $10.2 billion of sales in the next 30 days, compared with $10.9 billion on the previous trading day, the data show. Supply figures exclude derivatives and variable-rate debt. Some municipalities set their deals less than a month before borrowing.

Municipalities have announced $21.6 billion of redemptions and an additional $15.9 billion of debt matures in the next month.

Posey County, Indiana Economic Development for Midwest Fertilizer Co., Arizona Transportation Board and Dallas Area Rapid Transit have scheduled sales in coming weeks, the data show. Houston Independent School District and Rhode Island Tobacco Settlement Finance Corp. are also on the calendar.

BLOOMBERG

By Ken Kohn | Nov 17, 2014 4:46 AM PT

To contact the reporter on this story: Ken Kohn in New York at kkohn@bloomberg.net

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

---

NAST-NASACT Workgroup Issues Letter Regarding Changes to SEC Rule 2a-7 and the Impacts on Local Government Investment Pools.

The National Association of State Treasurers (NAST) and the National Association of State Auditors, Comptrollers and Treasurers (NASACT) has created a work group to examine the amendments to Rule 2a-7 impacting money market mutual funds (MMFs) that were approved by the Securities and Exchange Commission (SEC) on July 23, 2014. Among other things, the amendments will require institutional prime MMFs to adopt a floating net asset value (NAV) instead of the traditional stable NAV.

The work group is focusing primarily on the impact the amendments will have on local government investment pools (LGIPs), which in many cases are operated by state governments.

The work group has sent a letter to the Governmental Accounting Standards Board (GASB) requesting that GASB (1) add this issue to its technical agenda and (2) consider options that will allow LGIPs to continue using amortized cost (stable NAV).

View the letter.

S&P: Why Detroit's Bankruptcy Plan Outcome Doesn't Affect U.S. Municipal General Obligation Ratings.

Since June 2013, when Detroit's Emergency Manager announced the city would not make upcoming debt service payments and was poised to file Chapter 9 bankruptcy should settlements with creditors not be reached quickly, Detroit's lawsuits and court battles have been in the headlines. During this time, the treatment of debt and pension/other postemployment benefit (OPEB) obligations has attracted attention from market participants, including Standard & Poor's Ratings Services.

Standard & Poor's has followed the proceedings over the past 17 months and has carefully considered the bankruptcy's potential impact on general obligation (GO) and similarly supported ratings. In the end, despite months of headlines and court battles, ultimately the outcome of the Detroit bankruptcy will not have an impact on our GO ratings. This view is based on our feeling that there was no precedent set that is widely applicable to GO debt, and that the forward-looking nature of our U.S. local government criteria gives us opportunities to identify and take into account such weaknesses before issuers reach the point of deciding who to pay and not pay, either via bankruptcy or default.

Continue Reading.

07-Nov-2014

California's GO Debt Upgraded To 'A+' From 'A' On Strengthened Budget Stabilization Account; Outlook Stable.

NEW YORK (Standard & Poor's) Nov. 5, 2014–Standard & Poor's Ratings Services has raised its rating on the State of California's general obligation (GO) debt to 'A+' from 'A', and raised its rating on the state's general fund annual appropriation-secured debt to 'A' from 'A-'. The outlook on both ratings is stable.

"The upgrades follow voter approval on Nov. 4, 2014, of a strengthened budget stabilization account under Proposition 2," said Standard & Poor's credit analyst David Hitchcock. "In our view, the new state constitutional provision will partially mitigate California's volatile revenue structure by setting aside windfall revenue for use during periods when state tax revenue could fall materially short of forecast," Mr. Hitchcock added.

The enacted provisions have become part of the state constitution and, as such, cannot be overridden during the annual budgetary process. California has had a history of leaving its budget stabilization account (BSA) unfunded until the current budget year.

The upgrade on California's general fund appropriation-secured debt follows the upgrade on the state GO debt. This rating is below the GO rating due to pledged revenues subject to annual state appropriation.

Other key factors supporting the 'A+' GO rating include our view of California's:

Diverse economy of 38.3 million people, or 12% of the total U.S. population;
Recent commitment to aligning recurring revenues and expenses, while simultaneously paying down budgetary debts, and an improved cash position;
Timely enactment of budgets following a constitutional amendment requiring only majority legislative consent to approve budgets, which has reduced exposure to liquidity shortfalls; and
Moderately high bonded debt.
Somewhat offsetting these strengths are what we consider the state's:
Volatile revenue base, which is linked to difficult-to-forecast financial market performance because of a highly progressive income tax structure, and still relatively modest reserves as a percent of expenditures;
Potential for current structural budget balance to erode when voter-approved tax hikes fully expire in 2018, or sooner if the legislature were to significantly increase ongoing spending; and
Large retirement benefit and budgetary liabilities.
The state's general fund serves as the source of all GO bond repayment, to which California has pledged its full faith and credit.

The stable outlook reflects our view that California will build a material BSA fund balance in the coming years under recently passed Proposition 2, and that it will continue to pay down deferred liabilities and debt in advance of the 2018 expiration of a temporary income tax surcharge. The outlook also reflects a state financial position at the end of fiscal 2014 that was its strongest position of the past decade. The paydown of budgetary deferrals could accelerate if revenues come in ahead of budget, and trigger certain provisions in the budget. However, reserves are expected to remain slim in relation to budgeted expenses, while waiting for Proposition 2 to go into effect.
Potential developments that could lead to a positive outlook or upgrade would include an improved budget process, with a midyear budget review and an institutional framework for timely midyear corrective budget actions; or a reduction in the state's very significant pension, other postemployment benefits (OPEB), and debt liabilities. A downgrade could occur if significant structural budgetary imbalances reappeared, potentially due to a sharp decline in budgeted revenues, or if the state developed cash flow problems. Although California has recently addressed its teacher pension underfunding, the state continues to carry a large unfunded OPEB that could prove troublesome if not eventually addressed.

MMA Municipal Issuer Brief - What A GOP-Controlled Congress Could Mean.

Read the Brief.

November 3, 2014

California Credit Rating Raised After Voters Pass Reserve.

California's credit rating was raised by Standard & Poor's one day after voters in the most indebted U.S. state agreed to bolster a rainy-day fund for fiscal emergencies.

S&P boosted its rating one step to A+, fifth-ranked, the highest since February 2009. Only New Jersey and Illinois have lower ratings.

"This is the fourth upgrade for California by a rating agency in the past two years and it rewards the state for the immense strides it has taken toward fiscal discipline and budget stability since the Great Recession," Treasurer Bill Lockyer said yesterday in a statement.

Credit-rating companies have criticized California for its failure to set aside money when the economy is booming and for relying on volatile capital-gains taxes tied to the performance of the stock market, to finance the general fund, which pays for most core operations.

Proposition 2, championed by Democratic Governor Jerry Brown, sets aside 1.5 percent of general-fund revenue each year into a rainy-day fund, as well as capital-gains taxes that exceed 8 percent of the general fund.

Brown has steered the state to a projected surplus five years after it logged a record deficit. Temporary tax increases and a resurgent economy have fueled the turnaround.

Sixth-Highest

Standard & Poor's last boosted the state's rating in January 2013 to A, its sixth-highest grade and the best since January 2010. Fitch Ratings in August 2013 increased the state's grade to A, also sixth-highest.

Moody's Investors Service raised California's credit in June by one step to Aa3, the fourth-highest level, the state's highest mark with the company since 2001.

Investors demanded as little as 0.25 percentage point of extra yield yesterday to buy 10-year California obligations instead of top-rated municipal bonds, according to data compiled by Bloomberg. The spread was as high as 1.7 percentage points in 2009, when the state resorted to IOUs to pay bills.

Bloomberg

By Michael B. Marois Nov 5, 2014 9:01 PM PT

To contact the reporter on this story: Michael B. Marois in Sacramento at mmarois@bloomberg.net

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

---

SIFMA US Municipal Credit Report, Third 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 $71.8 billion in the third quarter of 2014, a decline of 13.6 percent from the prior quarter ($83.2 billion) but an increase of 5.2 percent year-over-year (y-o-y) ($68.3 billion). Year to date ending September, issuance figures reached $215.4 billion, well below the 10-year average of $277.3 billion. Including private placements ($2.1 billion), long-term municipal issuance for 3Q'14 was $73.9 billion.

Tax-exempt issuance totaled $64.7 billion in 3Q'14, a decline of 12.7 percent but an increase of 6.7 percent q-o-q and y-o-y, respectively. Taxable issuance totaled $4.9 billion in 3Q'14, a decline of 20.8 percent and 10.9 percent, respectively, q-o-q and y o y. AMT issuance was $2.2 billion, a decline of 22.6 percent q-o-q but an increase of 2.9 percent y-o-y.

By use of proceeds, general purpose led issuance totals in 3Q'14 ($21.7 billion), followed by primary & secondary education ($12.1 billion), and water & sewer facilities ($8.7 billion), identical rankings as the prior quarter.

Refunding volumes as a percentage of issuance rose slightly from the prior quarter, with 58.2 percent of issuance refunded compared to 53.8 percent in 2Q'14.

View the Report.

Municipal Trading Volume Dips in Third Quarter 2014.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today released municipal market statistics that show a 25.4 percent decline in the number of municipal bond trades for the quarter ending September 30, 2014 compared to the same quarter a year ago, among other findings. The MSRB's quarterly statistics published today include data on trading patterns, interest rate resets and continuing disclosure filings for the $3.7 trillion municipal bond market. The MSRB, which regulates the municipal market, is an independent source of market data and operates the Electronic Municipal Market Access (EMMA®) website to disseminate trading and disclosure documents and data.

Among the third quarter 2014 highlights:

- The total number of municipal trades in the third quarter of 2014 fell to 2.19 million, down 25.4 percent from the third quarter of 2013.
- Par amount of municipal securities traded in the third quarter of 2014 totaled $671.8 billion, down 18.6 percent from the $825.4 billion traded in the same period one year ago.
- Compared to the second quarter of 2014, par amount traded decreased 9.1 percent and the number of trades decreased 2.3 percent.
- Trading of fixed rate municipal securities decreased to $371.2 billion in the third quarter compared to the $493.2 billion traded in same period last year, a 24.7 percent decline.
- The number of variable rate demand obligations rate resets continued to decline in the third quarter to 155,170, down from 171,539 rate resets in the same period one year ago.

The MSRB's quarterly statistical summaries include aggregate market information for different

types of municipal issues and trades, and the number of interest rate resets for variable rate demand obligations and auction rate securities. The data also include statistics pertaining to continuing disclosure documents received through the MSRB's EMMA website. Daily and historical summaries of trade data based on security type, size, sector, maturity, source of repayment and coupon type are displayed in EMMA's Market Statistics section.

The EMMA website is a centralized online database operated by the MSRB that provides free public access to official disclosure documents and trade data associated with municipal bonds. In addition to current credit rating information, the EMMA website also makes available real-time trade data and primary market and continuing disclosure documents for over one million outstanding municipal bonds, as well as current interest rate information, liquidity documents and other information for most variable rate municipal securities.

Likely Default of Puerto Rican Utility Haunts Brokers, Muni Fund Managers.

The widely expected default of a Puerto Rican utility continues to weigh on some investment managers.

One in four U.S. municipal bond funds hold some exposure to the debt of the utility, the Puerto Rico Electric Power Authority or Prepa, a self-funded utility that provides electricity to nearly 1.5 million households and businesses on the island.

The approximately $1.7 billion in Prepa bonds held by mutual funds is a drop in the bucket for the $553 billion U.S. muni bond fund industry. And the exposures generally account for less than 1% of the total portfolio.

But 39 mostly single-state and high-yield funds have weightings around or above 2%, according to an InvestmentNews analysis of data from Morningstar Inc., including funds from OppenheimerFunds and Franklin Templeton Investments. Those funds account for about $33 billion in assets.

"Yields are not that high in fixed income," said Morningstar analyst Kiran Lalani. "It's a yield boost to add some of these bonds."

For single-state funds, managers are also limited in the number of securities they can buy and tend to fill out the rest of portfolios such as the Oppenheimer Rochester Maryland Municipal Fund (ORMDX) or Franklin New Jersey Tax-Free Income (FRNJX) with more Puerto Rican debt, according to Ms. Lalani.

The commonwealth said in an Oct. 30 report that the island's power utility may use its authority under a law passed by local lawmakers in June that would allow it to ask bondholders to take a loss.

Franklin Templeton Investments and OppenheimerFunds have both filed lawsuits in federal court alleging the debt-restructuring law is illegal.

Puerto Rico's debt-laden woes seem to have weighed on fund companies, too.

Oppenheimer's $26 billion muni operation saw nearly $5.3 billion in investor redemptions in the 12 months ended Sept. 30, according to Morningstar, while Franklin's $68 billion muni business saw nearly $4.9 billion in outflows over that time period.

Spokespeople for both firms declined to comment.

The Prepa securities are also a central subject in ongoing arbitration cases against brokers at firms including a UBS AG affiliate by investors who say they were sold Prepa bonds that subsequently lost value, according to Lawrence L. Klayman, a lawyer representing some investors in those cases.

A UBS spokesman did not respond to a request for comment.

Ms. Lalani, the Morningstar analyst, said that most fund managers have taken a cautious approach to the territory and reduced their exposures.

John V. Miller, the co-head of fixed income at Nuveen Asset Management, said in August that his firm had "reevaluated" its use of Puerto Rican securities in fixed income portfolios.

"At a minimum it's a high-yield play, if not a distressed-debt play, therefore it would only be a good fit in certain portfolios," he told InvestmentNews.

He said the firm had declined to participate in a lawsuit against the legality of Prepa's debt restructuring.

"It's a little bit academic in nature," said Mr. Miller. "Let's say it is unconstitutional, where's the money going to come from to pay the debt back?"

InvestmentNews

By Trevor Hunnicutt

Nov 6, 2014 @ 4:13 pm

Detroit Bankruptcy Taught Muni Investors Painful Lessons.

No matter what a federal judge decides today about approving Detroit's $18 billion bankruptcy plan, the record-setting case has already taught municipal bond investors some painful lessons.

Above all, pensions trump bonds, and when local politicians are forced to choose sides, Wall Street will be left out.

"It's pretty easy to stick it to the bondholders," said Lee Bogdanoff, a bankruptcy attorney who helped the second-largest U.S. municipality to suffer financial implosion, Jefferson County, Alabama, fight off demands by creditors holding billions of dollars in bonds.

U.S. Bankruptcy Judge Steven Rhodes is set to announce this afternoon whether he'll approve Detroit's proposal to eliminate $7 billion of debt, including some bonds backed by taxes. Rhodes must determine whether the plan is fair and feasible and whether to accept or overrule the objections of a handful of retirees who still oppose it.

During a two-month trial, Rhodes focused many of his questions on whether the plan was workable, repeatedly telling city officials he wouldn't allow them to enter into any more bad debt deals. He showed less concern about whether the plan was fair to bondholders and other financial creditors, like debt insurers.

Investor Education

“Hopefully this will educate not only investors, but also political leaders,” said Richard Ciccarone, a municipal debt analyst and president of Merritt Research Services in Chicago. “You can’t treat municipal debt as a risk-free investment.”

Detroit filed for bankruptcy in July 2013, listing $18 billion in liabilities. After decades of population decline and the disappearance of manufacturing jobs in the U.S. automotive capital, it could no longer meet financial obligations while providing essential services.

The city plans to spend about $1.7 billion to rebuild by removing blight and improving everything from police and fire protection to public transportation.

The case broke new ground in several areas, said James Spiotto, a bankruptcy specialist and managing director at Chicago’s Chapman Strategic Advisors LLC, which counsels on financial restructuring.

Sewer Sacrifices

Detroit pushed water and sewer bondholders to make sacrifices, even though their debt was guaranteed by the city’s utility, which wasn’t in bankruptcy and had been paying its debt on time. Eventually, the city refinanced some of those bonds at lower cost and left the rest unchanged.

The city also succeeded in forcing bondholders who held debt tied to property taxes to agree to take less than they were owed, something that municipal investors had assumed a bankruptcy court wouldn’t allow. Since those so-called general obligation bondholders were covered by insurance, any losses were passed on to the insurers, according to Spiotto.

“That was a gift of the bond insurers to the city,” he said.

The most important legal precedent to come out of the Detroit bankruptcy involved the protections state lawmakers had given to public-worker pensions. In a ruling that was later echoed in a case of Stockton, California, Rhodes found that when a city files for bankruptcy, those protections don’t apply because federal law trumps state law.

No Priority

That ruling should be a win for municipal debt investors because it means that from a legal perspective, retirees shouldn’t get priority over unsecured bondholders, said Bogdanoff, co-managing partner at Klee Tuchin Bogdanoff & Stern LLP, who’s not currently involved in the Detroit case. The debt should be considered equivalent, so each side would normally have to take about the same cuts.

In Detroit and in Stockton, however, local leaders predictably pushed plans that favored public workers over investors. So while the Detroit case gives investors a legal victory to leverage in future fights, it also teaches that, unlike corporate reorganizations, municipal bankruptcies are a very political animal.

“The more politically powerful group, the more sympathetic groups wound up doing better,” Bogdanoff said. “The Wall Street creditors really took it on the chin.”

Under the plan proposed by Detroit Emergency Manager Kevyn Orr and his team of legal and financial advisers, agreements were hashed out with the city’s large creditors, including retired

workers who accepted modest pension cuts; hedge funds that held pension-related debt; and nearby counties that objected to how the bankruptcy would affect the water and sewer services they receive from the city.

Art Protection

The settlements include an $816 million deal to bolster pensions in return for protecting city-owned art from liquidation; Detroit's agreement to pay $85 million to end interest-rate swaps valued at $288 million; and the pension debt settlements.

Before they settled, pension debt creditors, including hedge fund managers Aurelius Capital Management LP and BlueMountain Capital Management LLC, had argued that because they are being paid far less than retired city workers, the plan is unfair. As part of the settlements, those objections have been withdrawn.

"Until we get clarification from federal appellate courts, we have to conclude a municipality's general fund obligations are structurally subordinated to their pension liabilities," said Tom McLoughlin, head of municipal fixed-income at UBS Wealth Management Americas in New York. Under the bankruptcy code, a municipality "has more latitude to treat creditors in a disparate fashion than you'd see in a typical corporate reorganization," he added.

The case is In re City of Detroit, 13-bk-53846, U.S. Bankruptcy Court, Eastern District of Michigan (Detroit).

By Steven Church

November 07, 2014

To contact the reporter on this story: Steven Church in Detroit federal court at schurch3@bloomberg.net

To contact the editors responsible for this story: Andrew Dunn at adunn8@bloomberg.net Joe Schneider

---

How the Tribune Analyzed CPS' Bond Deals.

When Chicago Public Schools officials embraced auction-rate borrowing over traditional fixed-rate bonds, their goal was to save money for the financially strapped district.

From 2003 through 2007, the district issued auction-rate bonds four times, racking up a total of $1 billion in auction-rate debt, most of it paired with interest-rate swaps. The district refinanced the bonds in 2008, keeping similar maturity dates.

To assess the long-term success of this strategy, the Tribune conducted its own analysis of the deals and their future trajectory.

First, reporters calculated the total amount the district paid out on these deals, since CPS did not have that information. Reporters then estimated the future payments CPS will make on the refinanced deals.

As a comparison, the reporters estimated how much the district would have paid if it had opted to

borrow the same sum through traditional fixed-rate bonds with the same payment schedules.

Because such an analysis requires a variety of nuanced decisions that affect the final numbers, reporters consulted with academics and leading municipal bond experts to ensure that the Tribune's methodology was sound. One was Andrew Kalotay Associates, a debt management advisory firm that advised the city of Chicago on a recent bond issue. Another prominent firm, Municipal Market Advisors, also supported the Tribune's methods.

In the end, the Tribune analysis found that the district could end up paying $100 million more in today's dollars over the life of the deals than if it had stuck with safer borrowing methods.

The most complex part of the analysis involved constructing the hypothetical fixed-rate alternative to CPS' auction-rate deals. Here are more details about those calculations, as well as the objections raised by CPS officials and the district's longtime financial adviser.

The fixed-rate alternative

To estimate the costs for CPS if it had issued fixed-rate bonds instead of auction-rate securities, Tribune reporters relied on market data provided by Thomson Reuters MMD.

MMD rates are published every business day and are used in the municipal bond market as a benchmark for the return, or yield, that investors will receive.

That data gave the Tribune an idea of what yield investors would have demanded from CPS if the school district had issued fixed-rate bonds. From that information, reporters could construct hypothetical fixed-rate bonds and calculate the interest costs for CPS.

The term "bond" is used colloquially — and throughout the Tribune series — to refer to an issuance of several hundred million dollars in debt, whether auction-rate or fixed-rate. In fact, each of these bond issues is made up of a series of smaller bonds, with each one coming due in a different year. Investors buy shares of one or more of these bonds in exchange for payments of interest and — when the bond comes due — principal.

The MMD yield curves apply to premium fixed-rate bonds with an interest rate of 5 percent. Borrowers pay 5 percent on the entire bond issue even though the market would accept lower rates, especially for bonds that come due during the early years. In exchange, investors pay more upfront than the face value of a bond.

If CPS had issued premium fixed-rate bonds that delivered the same amount of project money that the district got from the auction-rate bonds, those fixed-rate bonds would have had a lower face value and a lower principal payment than the auction-rate bonds.

The Tribune calculated the lower face value of each of these bonds as follows:

For the four dates on which CPS issued auction-rate bonds, the Tribune obtained MMD yields for each year in which a bond was due.

Reporters used a Microsoft Excel function to convert those yields into prices. The price is the amount, stated as a percentage of the face value, that investors pay to buy shares of a bond on day one.

Reporters divided the face value of each of the auction-rate bonds by the corresponding prices to create smaller fixed-rate bonds — bonds with a lower face value than the auction-rate bonds — that

delivered the same project money.

Reporters then calculated the amount of interest CPS would pay on these smaller fixed-rate bonds at an interest rate of 5 percent. This enabled the Tribune to estimate how much CPS would have paid had it used traditional fixed-rate borrowing to bring in the amount of project money that the district obtained using auction-rate bonds.

Adjusting for refinancing

The MMD curves assume that the borrower will reserve the right to refinance the bond at par value — to pay back the principal amount of the old bond using money from a new bond issued at new rates — after 10 or more years.

This is typically part of the contract for fixed-rate bonds, including most fixed-rate bonds issued by CPS, as district officials acknowledged in interviews.

Because refinancing fixed-rate bonds can result in massive savings if rates drop, the right to refinance — or call — bonds has a lasting value. Few municipalities are willing to forgo that right, which is sometimes referred to as the call option.

Pairing auction-rate bonds with interest-rate swaps made it extremely unlikely that CPS could save money by taking advantage of that option, as swaps are costly to terminate when rates drop. But the school district likely would have been able to save money by refinancing if it had issued fixed-rate bonds instead.

Of CPS' four auction-rate bonds, three were issued in 2003 or 2004. If CPS had opted for fixed-rate bonds, the district could have refinanced them at par value in 2013 and 2014, when rates were significantly lower. (The fourth bond was issued in 2007.)

For its analysis, the Tribune assumed that had CPS issued fixed-rate bonds in 2003 and 2004, the district would have exercised its 10-year call option, as was common for municipalities across the country. Reporters used 2013 and 2014 MMD yield curves to create new premium fixed-rate refinancing bonds, then calculated the estimated interest payments from 2013 or 2014 until the final maturity date.

The Tribune did not attempt to determine how much could be saved by refinancing the 2007 bond. However, reporters did another kind of refinancing adjustment when they calculated the fixed-rate alternative for the 2007 auction-rate bond.

The 2007 auction-rate bond was itself a refinancing of a 1997 fixed-rate bond. The terms of the contract for that particular bond said it could be refinanced at par value in 2009. To refinance in 2007, CPS paid a $5 million premium; CPS opted to do that in order to enter into swap deals that provided $43 million in upfront cash.

The Tribune's hypothetical fixed-rate scenario assumes CPS would have avoided the premium for refinancing and waited until 2009 to refinance the bonds. Therefore, when totaling the cost of the fixed-rate equivalent, the Tribune calculated the interest on the 1997 bond from 2007 (when the auction-rate bond was issued) until the 2009 call date. Reporters then assumed the bond was refinanced and calculated the new interest payments using 2009 MMD yields.

Rates were particularly low in 2013-14, when three of the hypothetical fixed-rate bonds could have been refinanced. That significantly increased the cost difference between the fixed-rate and auction-rate options.

After reporters adjusted figures for the present value of future dollars, the cost difference between the two borrowing methods amounted to about $100 million. If reporters had assumed the school district would choose not to refinance the 2003 and 2004 bonds, the estimated savings would have been less: about $70 million.

The Tribune worked with Andrew Kalotay and others at New York City-based Kalotay Associates to develop its method of calculating the cost of CPS' hypothetical fixed-rate bonds. Concord, Mass.-based Municipal Market Advisors also reviewed the method and found it to be reasonable. Charles Jones, a professor at Columbia Business School, said the Tribune's methodology "makes perfect sense."

Choosing yield curves

Because CPS bought insurance on its auction-rate bonds and on most fixed-rate bond issues during the 2003-09 time period, reporters chose the MMD curves published for insured bonds, which assume the municipality buying the insurance has a rating of A. CPS at the time had slightly better ratings of A+ or AA-.

CPS officials later provided their own estimated yield-to-call values for that time period. For some bonds, those values were nearly identical to the MMD insured yields that the Tribune used.

The Tribune's decision to use MMD yield curves was partly a result of conversations with CPS and with Adela Cepeda of A.C. Advisory, a financial advisory firm that advised the school district on the bond deals.

But CPS officials and Cepeda both questioned the Tribune's use of insured yields. They argued that MMD insured yield curves are lower than what CPS would pay and thus underestimate what the district would have paid for fixed-rate debt.

"The MMDs are just indexes and they provide guidance, but they are not absolute indicators of where a deal should price," Cepeda said.

So the Tribune did a separate analysis to test the difference between the MMD yields it chose and the yields on CPS bonds issued around the same time as the district's auction-rate securities. In nearly every case, the Tribune found that the MMD yields were higher than yields on CPS bonds with the same maturities. This suggests that the Tribune's analysis underestimates the district's losses on auction-rate securities.

In constructing the three refinancing bonds that would have been issued in 2013 and 2014, the Tribune used a slightly more expensive yield curve. That is because CPS, like many municipalities, has backed away from the use of bond insurance in recent years. So the Tribune opted to use the MMD values for municipalities rated A. CPS had a rating of A+ in 2013, according to its annual financial report.

Calculating costs

When the Tribune calculated the district's costs on the auction-rate deals, reporters included interest payments on the bonds as well as net payments on the interest-rate swaps. To make those calculations, reporters used information from the swap confirmation documents and data compiled by Bloomberg and the Federal Reserve Bank of St. Louis, then spot-checked the results against paper records from CPS.

Much of the same data went into calculating past and future costs on the debt the district used to

refinance the auction-rate bonds after the auction-rate market collapsed in 2008. Two bonds were refinanced with fixed-rate debt, so future costs were simple to determine.

The remaining two were refinanced with variable-rate bonds pegged to the floating London Interbank Offered Rate, or Libor. To calculate future costs to CPS, the Tribune used estimated future rates provided by Andrew Kalotay Associates and derived from the Bloomberg U.S. dollar swap curve.

Reporters also used spot rates provided by Kalotay (also based on the Bloomberg U.S. dollar swap curve) to calculate the present value of future dollars by discounting the cash flows on an annual basis.

This was done for payments from 2014 onward on both the refinancing bonds and the hypothetical fixed-rate alternatives. The Tribune did not adjust the cost of past payments made since the first deal closed in 2003. But based on conversations with experts, reporters believe doing so would have had a minimal effect on the estimated cost difference.

The Tribune's analysis omitted some minimal costs that would have been incurred both on the hypothetical fixed-rate bonds and on the auction-rate bonds.

One was the cost of insurance on the initial bond issues. Documents showed that insurance costs were slightly higher when CPS issued auction-rate bonds than when it issued fixed-rate bonds; so to the extent that the omission of this cost affected the comparison, it made the auction-rate bond option look slightly better than it otherwise would have.

The Tribune also left out the issuance costs on both the initial bonds and any refinancing bonds. With one exception, all the bonds — whether fixed- or auction-rate — would have been refinanced once, so it was assumed the costs on both sides would be roughly equal.

The 2007 bond issue incurred two sets of issuance costs in the auction-rate scenario but only one set in the fixed-rate scenario, so again the omission would have made the auction-rate option look better.

Challenges, objections

In response to the Tribune's questions, both Chicago Public Schools and A.C. Advisory did analyses that compared the cost of the four auction-rate bond deals with what the school district would have paid for fixed-rate debt.

CPS' analysis covered a different time period than the Tribune's. While Tribune reporters looked at the cost of the deals through the final maturity dates, from 2030 to 2034, the school district's analysis ended at the present day.

For that 11-year period, CPS found, the costs associated with the auction-rate bonds were $30 million less than what fixed-rate bonds would have cost during the same period.

Several key factors helped determine that finding. One is that during the past 11 years, the school district has received or paid out several lump sums associated with its auction-rate deals. As mentioned above, the interest-rate swaps associated with the 2007 bond delivered a $43 million upfront payment to CPS.

The district also paid about $20 million in swap termination payments in 2008 when it refinanced its auction-rate bonds after the market collapse. Together, these one-time payments provided a net

benefit to the district of about $23 million.

CPS applied that benefit in its entirety to the initial 11-year period of the deals — even though the terms of the deals dictate that the school district will be paying the higher rates associated with the $43 million gain until 2030.

Another important factor in CPS' $30 million finding is that its analysis captures all the low payments the district made on its auction-rate deals from 2003 to 2007, before the deals blew up. But the analysis captures less than seven years of the much longer period the district will spend paying the higher rates it agreed to when it refinanced the deals in 2008.

CPS declined to address the question of whether auction-rate bonds or fixed-rate bonds would cost more over the life of the deals.

"We only looked at it through current day because we think that's the appropriate approach," said CPS Treasurer Jennie Huang Bennett.

If CPS wanted to end the deals today, however, it would have to pay $126.5 million to extricate itself from swap deals, according to valuations of the swaps in the district's 2013 annual financial report.

A.C. Advisory, which advised CPS on the auction-rate deals, chose — like the Tribune — to analyze the costs of the deals through maturity.

The company hired a New York City-based firm, Stanley P. Stone & Associates, which provides support services to municipal advisers and underwriters, to compare the cost of the school district's auction-rate deals with what fixed-rate bonds would have cost.

The firm's findings omitted one of the four deals, the one in 2007 that involved a refinancing of older debt. Cepeda said a comparison was inappropriate in that case because the school district "believed it could not" refinance those bonds at a fixed rate under terms of a 1997 intergovernmental agreement.

Cepeda later acknowledged that the district "may have been technically able" to issue fixed-rate debt but chose not to.

On the other three deals, Stone & Associates found that the school district had saved $64 million by issuing auction-rate debt rather than fixed-rate debt.

But the firm's analysis showed different costs for the auction-rate bonds than the payment amounts calculated by CPS or by the Tribune. In the case of one bond, Stone's cost-to-date was $20 million less than what the school district reported.

The firm's estimate of what CPS would have paid for fixed-rate debt, meanwhile, was much higher than the Tribune's estimate.

Stone's analysis assumed that if CPS had issued fixed-rate bonds in 2003 and 2004, it would not have chosen to take advantage of historically low interest rates by refinancing 10 years later. This increased the firm's estimated fixed-rate costs significantly.

CPS made the same assumption, showing no refinancings in 2013, though it had little effect on an analysis that ended in 2014.

Kalotay said any analysis "should have used the call option. Why would you disregard it?"

Matt Fabian of Municipal Market Advisors also said that assuming the bonds would be refinanced — as the Tribune did in its analysis — was the correct approach.

“That’s exactly what you should do,” he said. “That’s what would happen.”

The Chicago Tribune

November 7, 2014

By Heather Gillers and Jason Grotto

hgillers@tribune.com

jgrotto@tribune.com

Copyright © 2014, Chicago Tribune

Elections Season Could Shake Up Muni ETFs.

The municipal bond market, along with related exchange traded funds, have been steadily strengthening as austerity across local governments keeps supply low, but midterm elections could affect the munis market ahead.

For instance, in Illinois, the state income tax is a key factor to watch, according to Peter Hayes, Managing Director, head of BlackRock’s Municipal Bonds Group.

Specifically, the temporary tax increase to 5% is set to expire at year-end and will move back down to 3.75%. The Democratic incumbent governor wants to extend the tax increase while the Republican challenger is fine with letting it expire. If the Democrats have their way, the higher state tax rate would entice more Illinois investors to hold onto munis and benefit from the state tax exemption on Illinois-issued debt.

Additionally, in Pennsylvania, “pension reform will be a critical point on how the state is viewed by credit ratings agencies and broader municipal market,” Hayes added.

Muni ETF investors have a number of options to gain exposure to these state bonds. For example, the iShares National AMT-Free Muni Bond ETF (NYSEArca: MUB) includes a 5.3% tilt toward Illinois and 3.0% in Pennsylvania. The Market Vectors Intermediate Municipal Index ETF (NYSEArca: ITM) allocates Illinois 4.0% and Pennsylvania 2.2%. Additionally, the PIMCO Intermediate Municipal Bond ETF (NYSEArca: MUNI) holds 6.1% in Illinois-issued debt and 4.9% in Pennsylvania debt.

MUB has a 6.41 year duration and a 1.58% 30-day SEC yield or a 2.79% taxable equivalent yield for those in the highest income bracket. ITM has a 7.17 year duration and a 2.46% 30-day SEC yield or a 3.39% taxable equivalent yield. MUNI has a 4.65 year duration and a 1.15% 30-day SEC yield.

Moreover, there are just a few bond initiatives for this election season. For example, California’s Proposition 2, or the so-called Rainy Day Budget Stabilization Act, will help provide a greater cushion for the state government in case of another financial crisis or emergency.

The proposition “has the potential to significantly improve the state’s financial flexibility and credit

rating going forward," Hayes said.

California accounts for a large portion of the broad muni bond ETFs, including 22.7% in MUB, 15.1% in ITM and 11.7% in MUNI. Alternatively, investors can specifically target California muni bonds through the iShares California AMT-Free Muni Bond ETF (NYSEArca: CMF), SPDR Nuveen Barclays California Municipal Bond ETF (NYSEArca: CXA) and PowerShares Insured California Municipal Bond Portfolio (NYSEArca: PWZ).

October 28th at 8:20am by Tom Lydon

Act 47: Pennsylvania Says Enough Is Enough. Or Is It? Ballard Spahr.

Pennsylvania Governor Tom Corbett today signed House Bill 1773 (HB 1773) into law, significantly overhauling the Municipalities Financial Recovery Act, known as Act 47. Enacted in the 1980s to provide assistance to municipalities that were suffering from collapsed tax bases following the closure of many western Pennsylvania steel mills, Act 47 was intended to help distressed municipalities control their expenses (particularly labor arbitration awards), enhance revenue through additional taxing authority, and qualify for certain Commonwealth grants and no-interest loans on a priority basis.

Twenty-eight municipalities across the Commonwealth have been officially declared financially distressed under Act 47—with others contemplating such a determination, and undoubtedly even more able to qualify under the law if they wished to do so. Unfortunately, only nine have had their determinations lifted. It is noteworthy that 14 municipalities have been in the Act 47 program more than 10 years, some more than 20 years. Given the apparent difficulty of overcoming municipal financial distress (or the reluctance of municipal officials to make difficult choices required to alleviate it), and with the hindsight of an apparently successfully negotiated resolution to the City of Harrisburg's defaults and insolvency, the General Assembly determined to amend the law.

A New Timetable To Manage Distress

While Act 47 recovery plans are typically written with a five-year shelf life, after which an updated plan is typically put in place, the new amendments impose a five-year time limit for municipalities to exit Act 47. At the same time, the amended law permits the recovery plan coordinator to ask the local Court of Common Pleas for a one-time, three-year extension. For municipalities already in Act 47 and operating under a recovery plan, the termination date for their distressed status will be five years from the effective date of the most recent recovery plan or amendment. If their current plan is scheduled to expire within one year or less of the effective date of the Act 47 amendments, the municipality is subject to an automatic extension of three years from the termination date of the current recovery plan or plan amendment.

By adding this time limit, the Commonwealth is emphasizing the need for municipal officials to take a hard look at their underlying financial structure, including collective bargaining agreements. The question is whether the maximum of eight years under Act 47 will be enough time to implement significant and successful financial structural changes. Labor costs are one of the most significant contributing factors to a municipality's fiscally distressed status. Collective bargaining agreements, however, typically last four or more years. Under Act 47's new time limits, it is likely that a municipality will have at most only one opportunity to reduce its labor costs through collective bargaining during an Act 47 designation. The practical effect of the new amendments must be

warmly welcomed by municipal employees.

Since the expiration provisions may not provide sufficient time for a municipality to solve its labor cost issues, it is essential that a municipality times its entry into Act 47 when its collective bargaining agreements are scheduled to expire and that it uses the Act 47 tools effectively and fully when it has the opportunity to do so. While a time limit might be a reasonable idea, an arbitrary limit may be too short to permit meaningful change to alleviate long-term municipal fiscal distress. It is questionable whether five or eight years is enough time for a municipality to significantly reverse the other causes of fiscal distress, such as a declining population and eroding business tax base, deteriorating infrastructure, and declining investment, that in many cases have been declining for years. The main focus of a successful state oversight regime should be providing the tools that municipalities need to regain their footing; whether the new time limit and other amendments do so remains to be seen.

Four Exit Scenarios

In the fifth year of a municipality's Act 47 status, the recovery plan coordinator must complete a report setting forth the financial condition of the municipality and make one of the following findings:

- The conditions within the municipality warrant a termination of distressed status.
- The conditions warrant a three-year extension and exit plan.
- The conditions justify a request by the Secretary of the Department of Community and Economic Development (Secretary) for a determination of fiscal emergency.
- The conditions warrant disincorporation of the municipality.

After public notice, a comment period and a public hearing, the Secretary will issue an administrative determination of termination status and the reasons for such determination. Factors considered in the Secretary's determination include elimination of operating deficits, projected balanced budgets, projected revenues, stable debt obligations, and resolution of all financially adverse claims or judgments against the municipality. This determination is subject to appeal by specific parties identified in the new law, including a collective bargaining representative

Receivership: Doubling Down on the Harrisburg Approach

The mismanagement and crisis of inaction that resulted in the installation of a state-appointed receiver for the City of Harrisburg ended in 2013 with the adoption of the "Harrisburg Strong Plan"—the innovative financial recovery plan that allowed Harrisburg to avoid municipal bankruptcy and reposition itself for long-term renewal. The Harrisburg Strong Plan received national recognition, and the strategies implemented in it have been viewed as a potential "blueprint" for restructuring municipal obligations for distressed cities that is both cheaper and faster than a Chapter 9 bankruptcy filing. A number of the lessons learned from Harrisburg appear to have informed some of the Act 47 amendments.

Chapters 6 and 7 of Act 47 govern the fiscal emergency and receiver provisions. Upon the Secretary's request, the Governor may determine that a fiscal emergency exists if the distressed municipality is insolvent (or projected to be insolvent in the next six months), and the municipality either (1) is unable to continue providing vital and necessary services; or (2) has failed to approve the coordinator's plan or an alternative plan that had been approved by the Secretary. Upon determination of a fiscal emergency, the Governor may then formally declare the municipality to be in a state of fiscal emergency, and direct the Secretary to develop an emergency action plan to ensure the maintenance of vital and necessary services. During a state of fiscal emergency, the

Governor may exercise the authority of the municipality's elected or appointed officials and may assume any of their powers, including the powers to, among other things, collect funds, obtain emergency financial aid, and enter into contracts and agreements on behalf of the municipality for vital and necessary services. The elected and appointed officials may continue acting in their respective offices and capacities, as long as no action or decision conflicts with the emergency action plan, order, or exercise of power by the Governor.

Shortly after the declaration of fiscal emergency, the municipality's governing body must negotiate a consent agreement with creditors and any other interested parties. The consent agreement must incorporate a plan setting forth measures designed to provide long-term financial stability to the municipality and maintain vital and necessary services. Once a consent agreement is negotiated, the Secretary will decide whether to approve it. If the consent agreement is approved, the municipality's governing body must enact an ordinance adopting it. The status of fiscal emergency will end when the Secretary determines that the municipality is solvent and is not projected to be insolvent within 180 days or less, and is able to maintain vital and necessary services after the termination of fiscal emergency.

If the consent agreement is not approved, or the municipality fails to enact an ordinance adopting it, the Governor may appoint a receiver for the municipality. The receiver will then develop a recovery plan for the municipality. Such a plan is expected to ensure that vital and necessary services continue, the municipality's lawful financial obligations are paid, and required pension fund payments are deposited in a timely manner. The plan will also authorize a number of other actions, including the sale and conveyance of municipal property; approval, modification, or termination of contracts; and any other decisions the receiver deems appropriate.

The recovery plan must be confirmed by the Court of Common Pleas unless it finds clear and convincing evidence that the plan is arbitrary, capricious, or wholly inadequate to alleviate the fiscal emergency. Confirmation of a recovery plan requires the elected and appointed officials to undertake the acts set forth in the plan and suspends their authority to exercise power on behalf of the distressed municipality under law, charter, ordinance, rule, or regulation to the extent that such power would interfere with the powers granted to the receiver or the recovery plan's goals.

The receiver's term will end two years after appointment, with the option for one or more extensions of up to two years as approved by the court. The receivership also terminates automatically upon certification from the Secretary that the fiscal emergency has ended and the Governor rescinds the declaration. If the municipality remains financially distressed upon the expiration of the receivership period as determined by the Secretary, the recovery plan shall remain in effect and the Secretary will appoint (or re-appoint) a coordinator to administer the recovery plan in accordance with the timeline and requirements of Act 47.

Unlike some other states' receivership laws, notably Michigan's Act 436, the Commonwealth's receivership provisions under these amendments do not expressly allow a receiver to reject, modify, or terminate existing collective bargaining agreements. This difference is critical because high labor costs are usually the largest contributor to a municipality's fiscal distress. The new receivership provisions do, however, put labor leaders on notice that absent their willingness to negotiate contracts based on a municipality's reasonable capacity to pay for labor, the contracts may end up being impaired to a greater extent under a Chapter 9 bankruptcy proceeding.

Disincorporation – A Radical Approach

The original Act 47 anticipated that some municipalities may, in fact, be "nonviable" due to the long-term loss of their tax bases. In practice, the lack of interest in municipal consolidation on the part of

more financially balanced adjoining communities has prevented determinations of nonviability. The new amendments provide that a municipality unable to exit Act 47 could legally be deemed nonviable, resulting in "disincorporation." For purposes of this section of the law, a "municipality" is defined as a "county, city, borough, incorporated town, township and home rule municipality that does not provide a police service or fire service through its employees." The City of Philadelphia is not included in this definition, however.

The disincorporation provisions of the Act 47 amendments seem to be the clearest "warning shot" from the General Assembly to municipal leaders that their inability, or reluctance, to overcome perpetual financial distress will no longer be tolerated. While the reality of disincorporation may at first seem to position the distressed community for an easier path toward consolidation with skeptical neighbors, in practice, the disincorporation option may be of limited value if it does not apply to large numbers of municipalities with police and fire employees.Under the disincorporation provisions, if the Secretary determines that disincorporation is warranted, the Secretary must provide notice to the municipality's governing body and recommend disincorporation. Within 45 days of this determination, the governing body may enact an ordinance initiating the disincorporation, or, if the governing body fails to do so, a petition signed by a majority of registered electors of the municipality (those voting in the last gubernatorial election) may be submitted to the Court of Common Pleas. After another round of notice and hearing, the court will then issue a decree approving the ordinance's validity or granting the petition unless it finds by clear and convincing evidence that the municipality should remain incorporated because of a reasonable expectation that the municipality is viable.

If the court were to take the extraordinary step of issuing a disincorporation decree, a service district administrator would be appointed by the Secretary to establish an essential service plan. The service district administrator will enjoy broad powers, including the ability to sell or convey the municipality's assets; repay debts, bonds, and other obligations; seek a writ of mandamus against the municipality's governing body to carry out the disincorporation; approve, negotiate, or terminate contracts for services; identify essential services; apply for grants and loans; establish fees; and contract for professional services for the municipality. After the decree but before implementation of disincorporation, the municipality must enact a budget providing for the payment of every current obligation before the date of disincorporation and provide for the transfer and administration of any municipal pension assets to a private or public pension fund. The municipality's governing body may adopt recommended governing standards to be included in the essential service plan. Once the plan has been filed, there will be another round of notice, public meeting and comment, as well as an opportunity to appeal the final plan, before final filing of the plan.

On the date of disincorporation, the terms of all elected officials of the municipality automatically terminate and no person shall be elected or appointed, all ordinances of the municipality are nullified, all corporate powers granted to the municipality under its charter or the municipal code terminate, and the municipality shall be deemed an unincorporated service district.

Revenue Enhancement

The Act 47 amendments also set forth a number of changes to what municipalities operating under the program can do. These include expressly conditioning the increase in the earned income tax upon equal imposition on both residents and commuters. They also allow a municipality to triple the usual $52 maximum local services tax rate. It is important to note that municipalities will retain the ability to maintain this higher local services tax after exiting Act 47.

Municipalities in Act 47 will still not be allowed to change labor contracts already in place. They will, however, be able to pursue changes to labor contracts through the applicable collective bargaining

process and Act 111 interest arbitration procedures. The existing provisions of Act 47 mandate that the collective bargaining agreement that results from those procedures must comply with the Act 47 recovery plan that is in place at that time (with very limited exceptions).

The amendments also remove a provision allowing municipalities with distressed municipal pension plans to use added revenue from the higher local services tax to pay pension debt. Certain provisions are specific to Pittsburgh, which entered Act 47 in 2003. Unlike other Act 47 municipalities, Pittsburgh would not have an opportunity to increase its local services tax in lieu of an earned income tax. Act 47 does not apply to the City of Philadelphia.

Although the Act 47 amendments passed the General Assembly easily, these changes address Act 47 procedures and levels of state oversight; they do little to alleviate the underlying financial, demographic, or structural problems causing the financial distress. If nothing else, the amendments should serve notice to Pennsylvania municipal leaders and voters that the General Assembly expects municipalities to make meaningful and politically difficult decisions to address their fiscal situation in a timely manner, or risk losing local control of their municipalities. The legislative intent is clear: the days of perpetual Act 47 status and "treading water" financially are numbered. The question is whether the General Assembly has provided adequate tools to enable municipalities to achieve that result on schedule, or at all.

****

October 31, 2014

by William C. Rhodes, John P. McLaughlin, Patrick J. Harvey, Christopher R. Sullivan, and Kimberly D. Magrini

Attorneys in Ballard Spahr's Municipal Recovery Initiative have hands-on experience representing governments in matters of public finance; public-private partnerships; bankruptcy, restructuring, and capital recovery; labor and employment; tax; land use; and intergovernmental relations. Our attorneys have a track record of success helping financially distressed municipalities with issues such as accessing capital markets, negotiating and arbitrating labor contracts, and monetizing assets.

The firm's Public Sector Labor and Employment practice is a multidisciplinary labor and employment law practice that represents cities and municipalities in all aspects of Act 47, including the development of early intervention programs and financial recovery plans, pension and post-retirement health care issues, collective bargaining and grievance and interest arbitration under Act 195 and Act 111, and all other employment, labor, and personnel issues.

If you have questions about the Act 47 amendments, please contact William C. Rhodes at 215.864.8534 or rhodes@ballardspahr.com, John P. McLaughlin at 215.864.8241 or mclaughlinj@ballardspahr.com, Patrick J. Harvey at 215.864.8240 or harveyp@ballardspahr.com, Christopher R. Sullivan at 215.864.8508 or sullivanc@ballardspahr.com, or Kimberly D. Magrini at 215.864.8365 or magrinik@ballardspahr.com.

Copyright © 2014 by Ballard Spahr LLP.
www.ballardspahr.com
(No claim to original U.S. government material.)

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, including electronic, mechanical, photocopying, recording,

or otherwise, without prior written permission of the author and publisher.

This alert is a periodic publication of Ballard Spahr LLP and is intended to notify recipients of new developments in the law. It should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own attorney concerning your situation and specific legal questions you have.

Ballard Spahr: Regulators Decline to Exempt TOBs from Risk Retention Rule but Add Helpful Revisions and Clarifications.

Although regulators have rebuffed industry efforts to have tender option bonds (TOBs) exempted from the final credit risk retention rule (the CRRR), they have nevertheless provided some helpful changes and clarifications that may offset any disappointment with this decision. The rule implements Section 15G of the Securities Exchange Act of 1934, which was enacted as part of the Dodd-Frank legislation.

The CRRR governs risk retention with respect to asset-backed securities (ABS), some of which (like qualified residential mortgage loans) are exempt from the requirement. No exemption from the 5 percent risk retention requirement is provided, however, for sponsors of issuing entities concerning TOBs, a secondary market municipal bond financing technique, as many commenters had requested. It is worth noting that TOBs did not play any part in the financial crisis that led to Section 15G's enactment.

Our recent alert summarized key aspects of the CRRR, which was issued more than three years after it was originally proposed by the three prudential bank regulators, the Securities Exchange Commission, and the housing finance regulators (collectively, the Agencies). We noted that the CRRR largely tracked the version of the rule that was re-proposed in September 2013 (the Re-proposed Rule). With respect to TOBs, the final rule and accompanying release, in addition to providing certain technical changes and clarifications, also raise several issues that may merit further clarification.

A TOB involves the deposit of one or more highly rated (typically tax-exempt) municipal bonds (munis) into a trust and issuance by the trust of two classes of securities: floating rate, puttable securities (floaters) and an inverse floating rate (residual) security. TOBs provide municipalities with access to a diverse investor base and a more liquid market. The CRRR definition of TOB focuses on those features entitling the holders to tender such bonds to the issuing entity for purchase at any time upon no more than 397 days' notice, for a purchase price equal to the approximate amortized cost of the security, plus accrued interest (if any) at the time of tendering.

A key TOB-related concept in the CRRR is the newly created term "qualified tender option bond entity" (QTOBE), which is defined as a TOB issuer that:

- Issues no securities other than a single class of TOBs with a preferred variable return payable out of capital that itself meets the risk retention requirements
- Holds only tax-exempt munis as assets and issues only securities, the income from which is tax-exempt to investors
- Is collateralized solely by servicing assets and munis that are not subject to substitution and that have the same municipal issuer and the same underlying obligor or source of payment (without

regard to any third-party credit enhancement)
- Has a legally binding commitment from a regulated liquidity provider to provide a 100 percent guaranty or liquidity coverage with respect to all outstanding TOBs

The following discussion highlights the noteworthy changes and clarifications contained in the final rule, as compared with the Re-proposed Rule.

The CRRR's Definitions of TOB and QTOBE

- Deletion of any requirement that a TOB qualify for purchase by money market funds in accordance with Rule 2a-7 under the Investment Company Act of 1940
- Extension from 30 days to 397 days of the maximum notice period for tender by a TOB holder
- The clarification that the determination of same source of payment on the municipal securities is made without regard to any third-party credit enhancement
- The clarification that a QTOBE may hold a pass-through pro rata beneficial interest in an underlying tax-exempt municipal security

In addition, although the CRRR requires that a QTOBE have a binding commitment from a regulated liquidity provider to provide a 100 percent guarantee or liquidity coverage with respect to all of the issuing entity's outstanding TOBs, the release recognizes that such liquidity coverage may not be enforceable against the regulated liquidity provider upon the occurrence of a tender option termination event (TOTE). (TOTEs typically result from a bankruptcy, default, downgrade below investment grade, or event of taxability relating to the underlying bond(s) and other principal credit sources).

No changes were made to the Re-proposed Rule's requirements that the munis be tax-exempt or that they have the same municipal issuer or source of payment. Accordingly, QTOBEs may not hold taxable munis or pool bonds from different underlying obligors or credit sources.

Compliance by the Sponsor

The sponsor of a QTOBE is solely responsible for satisfying the risk retention requirements. The release contains two helpful clarifications regarding sponsor identification:

- Recognition that more than one party could meet the definition of sponsor for purposes of the rule, in which case the transaction parties may designate which party is the sponsor with responsibility for satisfying the risk retention rule
- Explicit comfort that designation of a party as the "sponsor" for purposes of the final rule bears no relationship to whether or not such party is the "sponsor" for other purposes, such as Rule 2a-7 under the Investment Company Act or the Volcker Rule

Risk Retention Methods

No changes were made regarding satisfaction of the risk retention requirements by a sponsor (a) by retaining an eligible vertical interest (at least 5 percent of each class of ABS issued) and/or an eligible horizontal interest (generally a first-loss interest in an amount equal to at least 5 percent of the par value of all ABS interests issued), (b) by retaining an interest that upon issuance meets the requirements of an eligible horizontal interest, but upon the occurrence of a TOTE will meet the requirements of an eligible vertical interest, and/or (c) by holding munis from the same issuance of, and with a face value equal to, 5 percent of the face value of the munis deposited in the QTOBE.

In the rulemaking, concerns were raised about how a TOB sponsor could retain:

- An eligible horizontal interest in the context of the TOB structure (which generally requires the sponsor to bear the first loss) without jeopardizing the tax rules for pass-through of the tax-exempt interest
- An eligible vertical interest (i.e., two classes of ABS interests with the holders of residual interests typically not also being holders of TOB interests)

To address these concerns, the Agencies specify that a residual interest in a QTOBE would meet the requirements of an eligible horizontal interest before, and an eligible vertical interest after, the occurrence of a TOTE under the following circumstances:

- Prior to the occurrence of a TOTE, the residual holder bears all market risk associated with the underlying tax-exempt municipal security
- After the occurrence of a TOTE, any credit losses are shared pro rata between the TOBs and the residual interest

Therefore, a first-loss residual interest is not required to satisfy the requirements for an eligible horizontal interest before a TOTE; and it is not necessary for the sponsor to hold both floater and residual interests to satisfy the requirements for an eligible vertical interest after a TOTE.

The final rule requires the sponsor to calculate the fair value of all ABS interests issued upon an issuance of TOBs that increases the face amount of TOBs then outstanding. Calculation of such fair value is thus required upon initial issuance of the TOBs, without any obligation to recalculate unless the face value of the TOBs outstanding exceeds the face value of the TOBs initially issued. If the face value of TOBs outstanding is increased—e.g., in connection with an additional deposit of munis, an increase in leverage, or the issuance of more TOBs to reflect the amount of accreted interest on zero coupon bonds—the fair value of the ABS interests would need to be recalculated to ensure that the risk retention percentage is satisfied.

Hedging

In response to questions regarding prohibited hedging of the required retained risks, the Agencies also clarified that, consistent with the treatment of other credit risk retention options in the final rule, the holder of retained credit risk may not hedge its exposure to the requisite retained 5 percent, but it may hedge any ABS interests or municipal securities in excess of the minimum requirement.

Disclosure

The CRRR requires the sponsor to provide certain mandatory disclosures to potential investors within a reasonable time before the sale of the ABS and, upon request, to the SEC or the appropriate federal banking agency. The final rule tailors the disclosure requirements as follows:

- Sponsors that retain munis outside the QTOBE must clearly disclose the identities of the TOB entity and the municipal issuer and specify the face amount of munis deposited in the TOB entity and the face amount retained outside the TOB entity and subject to the hedging prohibition.
- Sponsors that hold a residual interest meeting the requirements of an eligible vertical interest before a TOTE and an eligible horizontal interest after a TOTE must make the requisite disclosures required for both interests.

Effective Date

For TOBs, the rule is effective beginning two years after date of publication in the Federal Register. There will be no grandfathering of TOB entities formed before the effective date.

Some Open Issues

Several questions to be considered in applying the new rule include:

- The release provides that the holder of risk retention may divide the ABS interests or munis required to be retained among its majority-owned affiliates, but may not do so among unrelated entities that are managed by the sponsor or by an affiliate of the sponsor. May the residual interest be divided among related entities that are not majority-owned affiliates, such as multiple mutual funds in a fund complex? If so, may such entities designate a single residual holder entity as the "sponsor" with responsibility for satisfying the risk retention requirements?
- Does the prohibition on transfer of a retained interest prohibit pledging as security for a liquidity facility or credit enhancement the portion of a residual interest that is required to be retained?
- Can taxable munis be financed in a TOB-like structure and still satisfy the CRRR?

Ballard Spahr's Bank Supervision and Regulation practice and Public Finance Department include experienced lawyers who, among other things, counsel a variety of financial services industry clients and their boards of directors and senior management on a variety of transactional and compliance issues. Over the past several years, they have provided advice and counsel on, and transactional assistance in connection with, the myriad rules issued under Dodd-Frank.

****

by Keith R. Fisher and Joyce J. Gorman

October 31, 2014

For more information, please contact Keith R. Fisher in the Bank Supervision and Regulation practice at 202.661.2284 or fisherk@ballardspahr.com, or Joyce J. Gorman in the Public Finance Department at 202.661.2217 or gormanj@ballardspahr.com.

Copyright © 2014 by Ballard Spahr LLP.
www.ballardspahr.com

MMA Municipal Issuer Brief - Jobs, Housing & Local Governments.

Read the Brief.

New Bridges Between Louisville and Indiana May Set Standard for Financing Future Highway Projects.

LOUISVILLE —The concrete piers of two new bridges are rising out of the Ohio River between Louisville and Southern Indiana, as crews blast limestone and move earth to build the roads and tunnels that will soon connect the twin spans to nearby interstate highways.

For more than two decades, the project languished. Business and political leaders on both sides of the river couldn't agree on how to relieve snarled traffic, improve safety and spur development that was bypassing the region for Indianapolis and Nashville.

The Ohio River Bridges project is an American anomaly that has the potential to become a model while lack of money and political will are allowing many of the nation's roads and bridges to crumble. Along the shores of the Ohio, Democrat-led Kentucky and Republican-run Indiana have forged a partnership to rebuild U.S. infrastructure at a time of partisan gridlock and untapped trillions in private dollars.

"It's an enduring irony that the U.S., allegedly the home of innovation, is absolutely block-headed and backwards in this one respect," former Indiana Gov. Mitch Daniels, now the president of Purdue University in West Lafayette, Ind., said in an interview. "America needs the upgrade and modernization of our infrastructure, and I don't think you'll get there if you keep excluding, or at least discouraging, private capital."

The Obama administration, which had resisted private financing of public works, is starting a new center to serve as a one-stop shop for bringing capital into government projects. During a Sept. 9 infrastructure conference with investors, U.S. Treasury Secretary Jack Lew said that while direct federal spending is indispensable in such cases, tight budgets demand creative ways for unlocking private money.

His cabinet colleague, Transportation Secretary Anthony Foxx, put it more bluntly when he announced the Build America Investment Initiative in July.

"There will always be a substantial role for public investment," Foxx said. "But the reality is we have trillions of dollars internationally on the sidelines that are not being put to work."

Fixing those roads and bridges also boosts employment. Every $1 billion in new infrastructure investment creates about 18,000 jobs, according to a 2009 report by economists at the University of Massachusetts' Political Economy Research Institute.

An Indiana economic-impact study estimated that the Ohio River Bridges project alone will generate an average of 15,500 jobs annually through 2042. Planners also promise a safety dividend as well: The river's juncture is a national crossroads of truck traffic that has seen higher accident and injury rates than U.S. averages, according to a crash study.

For Indiana's share of the $2.3 billion project, the state is using WVB East End Partners to finance, design, build and maintain for 35 years a new bridge and highway approaches. The group consists of Walsh Investors of Chicago; Vinci Concessions, based in Rueil-Malmaison, France; and Bilfinger Project Investments North America, a division of the German builder Bilfinger.

While Kentucky lacks the legal authority for such a deal and is using more traditional public financing for its portion, Democratic Gov. Steve Beshear is pushing for legislation to allow Kentucky to use public-private partnerships for transportation work. The old model of relying on federal funding is no longer viable, he said.

"The practical facts are that if we are going to have any large infrastructure projects in the foreseeable future, it's going to have to involve the private sector," Beshear said. "That's where the money is, and that's where people are willing to put money up in order to get these projects built."

Institutional investors such as Montreal-based Caisse de Depot et Placement du Quebec have capital and want to invest in U.S. infrastructure because it meets their long-term objectives, said Macky Tall, Caisse's vice president of private equity and infrastructure. The Caisse is Canada's second-biggest pension-fund manager, with $190.7 billion in net assets as of June 30.

There hasn't been more investment because the U.S. is behind other countries in tapping private

capital, Tall said, and there's been a lack of expertise, legal authority or receptivity to it in some parts of the country.

"We as the investors keep it very simple: We only go and invest where that capital is desired and considered helpful," he said. "We really only make these investments where there is appetite for that capital."

Tall said states are becoming more comfortable with private investment, in part because there are more examples of successful projects and fewer alternatives to pay for mounting infrastructure needs.

The United States has used mostly fuel taxes and public financing for such projects. And the federal gasoline tax hasn't been raised since President Bill Clinton was in office. A divided Congress only managed a short-term measure in July to prevent the Highway Trust Fund from becoming insolvent.

California passed the first legislation allowing public-private partnerships for transportation projects in 1989. Today, 33 states and Puerto Rico have such authority, according to the National Conference of State Legislatures.

After years of debating the Ohio River bridges, Daniels and Beshear got on the phone late in 2011 and agreed to split the work, paying for each share separately.

Kentucky's portion includes a new six-lane downtown bridge for northbound Interstate 65 from Louisville and a reconfigured "Spaghetti Junction" where I-65 meets Interstates 64 and 71. The existing Kennedy Bridge will be rebuilt and will handle southbound I-65.

Indiana is building a new bridge eight miles upstream connecting Louisville's east end with Southern Indiana while also expanding highways and building twin tunnels under historically protected property in eastern Jefferson County.

The east-end bridge will connect Interstate 265 in Kentucky, also known as the Gene Snyder Freeway, with I-265 in Indiana, creating a bypass around Louisville.

(For example, travelers from Lexington to Indianapolis or Chicago could take the I-265 loop and avoid downtown Louisville.)

Indiana's financing approach won "project of the year" recognition last year from groups including the Washington-based American Road & Transportation Builders Association, which called it "a prime example of the ingenuity" of public-private partnerships. The tools had been used before, though rarely on a project of such scale involving two state governments, the association said.

Kentucky is using more traditional financing that includes bonds backed by toll revenue, a low-interest federal loan and Grant Anticipation Revenue Vehicles bonds, or Garvees.

The failure to craft more innovative approaches has left an unmet U.S. infrastructure need that the American Society of Civil Engineers estimates will reach $3.6 trillion by the end of the decade. The list of stalled projects includes a replacement for the Interstate 5 bridge connecting Portland, Ore., and Vancouver, Wash., and a new Brent Spence Bridge on Interstates 75 and 71 between Northern Kentucky and Cincinnati.

Officials in those states have been unable to agree on the scope or funding as Kentucky and Indiana have with the Ohio River Bridges. Beshear said he'd like private financing as an option for the Brent Spence Bridge, just as public-private partnerships have been used for the Denver FasTracks rail

project and the replacement of the Goethals Bridge between New York City and New Jersey.

Institutional investors say they would like to invest more in public infrastructure — if only there were more suitable projects willing to take their money. If there were, it would mean an additional $2.5 trillion in investment globally through 2030, according to a 2013 study by the McKinsey Global Institute. The U.S. has the potential to be the largest public-private partnership market in the world because of the size of its infrastructure and urban populations, Moody's Investors Service said in a Sept. 8 report.

The swift financial closing of the Ohio River Bridges project — fewer than nine months — suggests the U.S. is ready for more public-private partnerships, said Xavier Huillard, Vinci's chief executive officer.

One remaining barrier to private investment is that projects generally require a dedicated funding stream such as tolls, which some Americans oppose on top of paying taxes, said Robert Palter, director of McKinsey's infrastructure practice in Toronto.

While residents in Louisville and Southern Indiana aren't happy about tolls for the new Ohio River bridges, the work has been needed for decades, said Rebecca Bethard, who bought a house with her husband that overlooks the bridge work in Indiana. It will cut her 40-minute commute to Louisville in half, and the value of their home should only increase, she said.

"Tolls are a fair trade-off for getting it done," Bethard, an attorney, said in an interview. "The benefits outweigh the costs."

The unreliability of conducting business in the region was significant, said Kerry Stemler, chairman of the Louisville area's chamber of commerce, who helped lead a bi-state bridges authority. U.S. military convoys have even diverted around Louisville because of the congestion, he said.

"Not to move forward with this project basically was saying to this city and this part of the country that we're not going to be participating in the future growth of the country, and that's not acceptable," Louisville Mayor Greg Fischer said in an interview.

BY MARK NIQUETTE
Bloomberg News
October 27, 2014

New Challenges for Keeping Public Money Safe.

Governments across the country face a significant fiscal dilemma: sacrifice yield on their bank deposits or assume more risk.

Still reeling from the financial turmoil over the last few years, banks have recently told governments of all sizes that, because of changing regulatory requirements and business practices, the financial institutions may no longer be in a position to provide the mandatory amount of collateral to protect public deposits. This creates concerns about alternative ways to secure collateral as well as the need to develop new standards to protect taxpayer funds.

The yield on many depository accounts is stuck at record lows, yet the cost to financial institutions of collateralizing or otherwise securing these accounts continues to increase. Many governments are

struggling to find depository accounts that meet their legal requirements and risk-tolerance levels. This is forcing officials to evaluate policies for mitigating risk without sacrificing yields on the deposits.

The Federal Deposit Insurance Corporation (FDIC) provides federal depository insurance up to certain thresholds for accounts maintained in FDIC-insured banks and savings associations. The standard insurance amount totals $250,000 per depositor, per insured bank, for each account ownership category. But what about bank balances of deposit accounts in excess of federal depository insurance?

Unfortunately, many governments' investment policies only address FDIC insurance and not other forms of depository insurance that may be available. Modifying investment policies would address this issue, barring statutory restrictions on accepting other forms of depository insurance.

To mitigate some of the risk of uninsured and uncollateralized deposits, some states allow use of single- or multiple-financial-institution collateral pools. In a single-institution pool, an institution pledges a group of securities against all of its public deposits. In a multiple-institution pool, various institutions pledge a group of securities to provide common collateral for their deposits of public funds. In this scenario, the assets of the pool and the power to make additional assessments against its members ensure that no loss of public funds occurs due to the default of a member.

Therefore, a multiple-institution collateral pool is considered depository insurance, while a single institution collateral pool is considered collateral. Many government investment policies don't address the use of either type of pool, which may limit a government's ability to improve the yield on its depository accounts. A change in a government's investment policy could address this issue for a single-institution collateral pool, but the creation of a multiple-institution pool may require a change in state laws.

Alternatives to collateral pools have surfaced to assist governments in improving yield without sacrificing risk. One example is Insured Cash Sweep services (ICS), where governments can access multimillion-dollar FDIC insurance on public funds placed into demand deposit accounts, money-market deposit accounts, or both, in increments below the $250,000 FDIC limit. The use of ICS services may require a change in state statutes — it's currently approved in 42 states — and a change in a government's investment policy.

Another alternative is public unit deposit letters of credit (LOCs), which offer a less-expensive alternative to collateral. A Federal Home Loan Bank issues the LOCs to pledging banks and assists them in mitigating risk for collateral pledged to local-government deposits. Using a LOC also may require a change in state statute or a local-government investment policy.

Governments often rely on yields on their deposits to fill budgetary holes, and this new era of collateralizing public deposits threatens a government's ability to make ends meet. Governments cannot afford to stand back and watch. It's time to be proactive, investigate alternatives and implement investment policies that align with the reality of today's banking sector.

GOVERNING.COM

BY FREDERICK G. LANTZ | OCTOBER 30, 2014

New Rule Could Require Governments to Report Tax Incentives as Lost Income.

Corporate tax incentives have become an increasingly popular way for state and local governments to try to attract new businesses. Now those subsidies could begin affecting governments' budgetary bottom lines, under an accounting change being considered that would require reporting those incentives as lost income in annual financial reports.

On Friday, the Governmental Accounting Standards Board (GASB) issued for public comment proposed rules for requiring state and local governments for the first time to disclose information about property and other tax abatement agreements. If approved, the new disclosures could shed light on a previously murky area of government finance and provide hard data on information that has often been assembled piecemeal, if at all. Stakeholders have until Jan. 30, 2015 to comment.

"This is huge," said Greg LeRoy, executive director of Good Jobs First, a policy center that advocates for transparency in economic subsidies. "If you care about school finance or smart growth or regionalism or land use in general, this data will enable you to figure things out that were unthinkable before."

Many state and local governments currently have tax abatement programs in place, and the impact of those abatements can be substantial. But there's no way to know the magnitude or the nature of those programs just by looking at government financial statements. Efforts to track such data in the past have been initiated by third-party organizations like Good Jobs First or by media outlets. In 2012, The New York Times reported that state, county and city incentives total some $80.4 billion every year. Texas led the nation in incentives, according to the Times, offering around $19 billion annually.

"Tax abatements can significantly reduce the amount of revenue a government receives," said GASB Chair David A. Vaudt in a statement. "But in many cases, little is known publicly about their total size or their terms and conditions. What the Board has proposed would make the financial impact of these transactions much more transparent."

The proposed tax abatement disclosure requirements would include:

• The tax being abated

• Criteria that must be met for the taxpayer to be eligible for the abatement

• Provisions for recapturing abated taxes

• The types of commitments made by tax abatement recipients

• Number of tax abatement agreements

• Dollar amount of taxes abated

• Other commitments made by a government, such as to build infrastructure assets.

LeRoy said that data could have the biggest implications for school districts, which in most cases are funded by property taxes. Under the proposed disclosure requirements, part of property tax abatements whould show up as lost income for districts. Good Jobs First has released its own analysis of the requirement's implications.

“Schools are obviously the biggest losers when councils grant property tax abatements and tax increment financing agreements,” LeRoy said. “Typically about half of that money would have gone to school districts.”

Also of note is the provision requiring governments to report the criteria that businesses must meet for the abatement and how governments will get that money back if the goals aren’t achieved, commonly referred to as clawback provisions. That requirement “puts this on the forefront of disclosures,” said Justin Marlowe, a Governing contributor and a public finance professor at the University of Washington’s Evans School. “The fact that they’re going to make entities disclose whether they’ve ever done a clawback is really big and will reveal something about that jurisdiction from a policy standpoint that might not otherwise be clear.”

A change of this magnitude is sure to meet resistance. GASB, established in 1984, has a history of stirring the pot with its proposed accounting standards — so much so that it was the subject of a 2009 Journal of Financial Management article that outlined the board’s increasingly tumultuous role in government accountability in accounting. And in 2007, the Government Finance Officers Association went so far as to try and abolish GASB and transfer the board’s responsibilities to the organization that sets accounting standards for the private sector.

Marlowe predicts strong pushback from those who would argue that reporting tax abatements isn’t an accounting issue – that policymakers think of these decisions as investments, rather than a drain on finances. “But I think what GASB is saying is that state governments and others have had plenty of chances now to put this out there,” Marlowe said. “A lot of what the GASB has done recently is say, ‘Look, no one else is stepping up. If we have to be the ones, than that’s what has to be done.’”

GOVERNING.COM

BY LIZ FARMER | OCTOBER 31, 2014

Stockton’s Costly Bankruptcy May Not Tempt Other Cities.

Stockton, California, is emerging from bankruptcy saddled with legal bills and a damaged reputation that will deter other U.S. cities from seeking a path through court to cut their debts.

“The leaders of distressed U.S. municipalities will continue to pursue other options before setting in motion the long and costly process that bankruptcy implies,” Chris Morgan, director in the San Francisco office of Standard & Poor’s, said yesterday in a statement after a judge approved the city’s debt-adjustment plan. “We believe that the implications of Stockton’s exit from bankruptcy will be modest.”

Stockton, a city of 298,000 about 80 miles (130 kilometers) east of San Francisco, filed for bankruptcy in June 2012 after the housing market collapsed, retiree health-care costs mounted and tax revenue eroded. It was one of three California cities to file for bankruptcy that year.

U.S. Bankruptcy Judge Christopher Klein in Sacramento, California, yesterday approved Stockton’s plan to exit court protection by paying bond investors pennies on the dollar while shielding public pensions. In doing so, he warned other cities about the costs of municipal bankruptcy and said it “shouldn’t be entered into lightly.”

As of May, the city had paid lawyers and other advisers almost $14 million, according to court

filings.

The bankruptcy filing was unavoidable, Connie Cochran, a Stockton spokeswoman, said in a phone interview.

‘Insolvent’ City

“We were insolvent both from a service perspective and fiscally,” she said. “We recognize that we need to live within our means and follow the plan that we’ve developed.”

Stockton will begin to exit bankruptcy once the judge sets a date, possibly by the end of the year, Cochran said.

The plan calls for a $5.1 million contribution for canceling retiree health benefits. Also, Stockton voters last year approved a proposal to increase the city’s sales tax to 9 percent to generate about $28 million annually, which would go toward exiting bankruptcy, restoring city services and paying for law enforcement.

The police department is having trouble keeping employees, who are leaving because of low pay, said Kathryn Nance, president of the Stockton Police Officers’ Association, which represents about 360 officers.

“It’s still going to be a very long road just to get back to where we were before,” Nance said in a phone interview. “We are the lowest-paid police force in the county and with the compensation packages and benefits, people are leaving to go to other agencies.”

‘Doesn’t Change’

The bankruptcy exit “doesn’t change the difficult economic environment” in the city, said S&P’s Morgan. In assessing its creditworthiness, “the main thing we’re going to be looking at is a willingness to meet their obligations and their overall financial health,” he said in a phone interview.

The city passed on an option presented by Klein to end its contract with the California Public Employees’ Retirement System, the biggest U.S. public pension fund. Doing so would have reduced pensions by 60 percent and caused many employees to leave, Marc Levinson, Stockton’s lead bankruptcy attorney, had warned.

Still, Klein’s ruling could set up future challenges from California cities burdened by retiree obligations.

“Local governments will now have more negotiating leverage with labor unions, who cannot count on pensions as ironclad obligations, even in bankruptcy,” Gregory Lipitz, a vice president and senior credit officer at Moody’s Investors Service, said in a research note yesterday.

Detroit Plan

Stockton’s bankruptcy was dwarfed by Detroit’s. The city of about 700,000 filed a record $18 billion municipal bankruptcy last year, saying decades of decline left it unable to provide basic services while still meeting financial obligations. Its plan to trim about $7 billion in debt by reducing some bond recoveries and cutting retiree benefits goes up for court approval next week.

“Ultimately, the decision in Stockton highlights a unique and unfortunate situation brought on by the financial collapse of 2008, and thankfully not a situation that the overwhelming majority of

municipalities have to face," Teague Paterson, a pension attorney at Beeson, Tayer & Bodine, said in a statement.

The case is In re Stockton, 12-bk-32118, U.S. Bankruptcy Court, Eastern District of California (Sacramento).

By Alison Vekshin and Michael Bathon

Oct 30, 2014 9:01 PM PT

To contact the reporters on this story: Alison Vekshin in San Francisco at avekshin@bloomberg.net; Michael Bathon in Wilmington at mbathon@bloomberg.net

To contact the editors responsible for this story: Andrew Dunn at adunn8@bloomberg.net; Stephen Merelman at smerelman@bloomberg.net Peter Blumberg

---

New York City Pension Funds Slow Growth of Wall Street Fees.

New York's five pension funds paid Wall Street investment managers $530.2 million in the most recent fiscal year, an 8.5 percent increase, according to the city's annual financial report released today.

The rate of growth in the year through June slowed compared with the previous period, when expenses paid to the city's almost 250 managers rose 28 percent.

New York City Comptroller Scott Stringer, who serves as chief investment adviser to the pensions, has vowed to reduce fees and increase internal management. Fees erode returns crucial to funding benefits for New York's more than 237,000 retirees and future payments to 344,000 employees.

Pension assets for police officers, firefighters, teachers, school administrators and civilian employees rose about 17 percent to $160.6 billion in the 12 months ended June 30, according to the report.

Eric Sumberg, a spokesman for Stringer, didn't immediately respond to a request for comment.

By Martin Z. Braun

Oct 31, 2014 11:49 AM PT

To contact the reporter on this story: Martin Z. Braun in New York at mbraun6@bloomberg.net

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

---

Record Rally Reaches 10th Month as Volatility Rises: Muni Credit.

The $3.7 trillion municipal market is set to gain in October, weathering the highest volatility since January to extend a record rally.

State and local debt has earned 0.7 percent through Oct. 30, according to Bank of America Merrill Lynch data. The 10th straight month of gains in 2014 marks an unprecedented stretch to start a year since the data begin in 1989. The highest top tax bracket since 2000 is helping fuel demand. Yields on benchmark 10-year munis have dropped 0.1 percentage point this month to 2.12 percent, data compiled by Bloomberg show.

Global financial markets gyrated in October as investors fretted that global growth was slowing. For munis, the 30-day volatility on benchmark 10-year yields reached the steepest since Jan. 14. During a 30-day rollercoaster, interest rates plunged along with Treasuries and then climbed by the most in 16 months as investor demand waned.

“When you look at year-to-date total returns, it’s been pretty impressive,” said John Flahive, Boston-based director of fixed income at BNY Mellon Wealth Management, which oversees about $20 billion in munis. “It just seems we have much more sensitivity, given how low in rates we are, to following the volatility of the Treasury marketplace.”

Until the current rally, the longest win streak to start a year was five months in 1991, Bank of America data show. The 9 percent return for munis in 2014 has defied forecasts of analysts and investors, who predicted a second year of losses after a selloff in 2013.

Instead of rising, yields have dropped, luring states and cities to borrow. Municipalities are on pace to issue $36 billion of long-term, fixed-rate bonds in October, the highest monthly total since March 2013.

Investor appetite weakened after benchmark 10-year yields touched 1.94 percent Oct. 16, the lowest since May 2013. Individuals added $37 million to muni mutual funds this week, down from $444 million two weeks ago and the lowest since August, Lipper US Fund Flows data show.

BlackRock Inc. (BLK), the world’s largest money manager, sold some local debt as yields declined, according to Peter Hayes, who oversees $122 billion as head of munis at the New York-based company.

Ten-year yields then surged 0.16 percentage point to 2.14 percent in the week through Oct. 24, the biggest jump since July 2013, as buyers balked at the lower rates.

Ride’s End

“The mid-month volatility for munis was extraordinary,” said James Dearborn, head of munis in Boston at Columbia Management Investment Advisers, which oversees about $30 billion in local debt. “At the end of the ride, which to some people probably felt unpleasant, we’re at a better, more justifiable level than where we started.”

Muni volatility also rose relative to that on Treasuries. Because individuals own about 60 percent of the municipal market and most debt doesn’t trade on a daily basis, state and local bonds have historically been less volatile than their federal counterparts. Yet on Oct. 27, the 30-day muni yield volatility reached the closest to the measure for Treasuries in three months.

‘Better Place’

As munis swung in value, the market cheapened compared with federal obligations. The ratio of yields on 10-year munis to those on similar-maturity Treasuries rose to 94 percent on Oct. 24, the highest since July. A rising figure signals that state and local debt is increasingly cheap. The measure is still below the five-year average of 98 percent.

“Volatility never feels good, but if we cheapened a little bit to Treasuries, that puts us in a better place going forward,” Dearborn said.

October’s issuance glut may not carry over into the next two months, re-establishing the 2014 trend of slowing supply. States and cities have scheduled $8.3 billion of bond sales in the next 30 days, down from $13.7 billion on Oct. 15, Bloomberg data show. Issuance in 2014 is about 6 percent below the 2013 pace.

The gains in the face of higher volatility may give investors confidence that state and local debt will retain value even if interest rates rise next year, as projected in a Bloomberg survey of more than 70 analysts.

“It all happened so fast,” said Blake Miller, who helps oversee $10 billion of munis at Neuberger Berman Group LLC in New York. “But after going over that speed bump, we ended the month in pretty good fashion, with yields down across the board.”

By Brian Chappatta

Oct 31, 2014 8:05 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

---

Judge Approves California City’s Bankruptcy-Exit Plan.

The federal judge overseeing the two-year-long bankruptcy of Stockton, Calif., ruled Thursday that the distressed city can exit court protection without deeper cuts to its pension obligations.

U.S. Bankruptcy Judge Christopher Klein called the city’s reorganization plan, which raises taxes and slashes payments to bondholders, “the best that can be done” during a hearing in Sacramento.

The decision is a victory for public-pension advocates who worried the judge would reject the plan because the city didn’t cut obligations to California Public Employees’ Retirement System, which controls city workers’ retirement money. The same judge about a month ago said the city had the power to sever its ties with the retirement system, known as Calpers. The judge overseeing Detroit’s bankruptcy case has also ruled that payments into pension funds can be reduced while a city is insolvent.

The resolution of the Stockton case is “unlikely” to lead other U.S. cities to view bankruptcy “as an attractive option for resolving serious financial challenges,” said Standard & Poor’s Ratings Services in a statement.

Calpers, the largest public pension in the U.S., said in a statement, “The judge recognized that the city’s employees and retirees have already made significant concessions” and “that further impairing pensions would harm them even more.”

Judge Klein approved the city’s reorganization plan over protests from two Franklin Templeton Investments-managed funds, which underwrote the bonds for Stockton’s fire stations and parks. The

funds argued that the city could afford to repay more than its $4 million offer.

Critics of the exit plan have said the city will continue to struggle to afford the state-mandated payments to Calpers.

“We are disappointed,” Franklin Templeton lawyer James Johnston said after the ruling.

Meanwhile, many pension fund lawyers applauded the judge’s decision. Harvey Leiderman, a partner at Reed Smith LLP who represents public-employee pension funds, said the confirmation of Stockton’s plan “threw cold water on anyone who thinks there is an easy exit off ramp for resolving your fiscal issues” through a municipal bankruptcy. Calpers is a client of Mr. Leiderman’s, but he didn’t represent the system in the Stockton case.

“The outcome in Stockton is more evidence that bankruptcy is not an appropriate tool to jettison pension debt,” said Teague Paterson, a lawyer at Beeson, Tayer & Bodine, who also represents pension funds and who filed a brief in the Stockton case.

City leaders put Stockton, a city of 300,000 people located about 80 miles inland from San Francisco, into bankruptcy in June 2012, after it was hit hard by the housing crash. Judge Klein also blamed the city’s financial woes on former leaders who offered overly generous pay to city workers and took on debt for new projects that the city couldn’t afford.

It was the second-largest financial failure by a U.S. city and one of several California cities—San Bernardino, Vallejo and Mammoth Lakes— to seek bankruptcy protection in recent years. It needed a judge to approve its plan to repay creditors before it could exit from bankruptcy.

Instead of cutting payments to Calpers, the city chose to raise taxes. Last year, voters approved a 3/4-cent sales tax to pay for more police officers. More than 1,000 workers and retirees who had $538 million in claims against the city also agreed to accept one-time payments worth $5.1 million instead.

The judge on Thursday highlighted how much the city spent during its two years in bankruptcy, saying that legal fees amounted to $13.8 million. “It’s impossible” to go through a municipal bankruptcy, he said, “without spending an eight-digit number.”

THE WALL STREET JOURNAL

By KATY STECH and DAN FITZPATRICK

Updated Oct. 30, 2014 5:00 p.m. ET

Write to Katy Stech at katherine.stech@wsj.com and Dan Fitzpatrick at dan.fitzpatrick@wsj.com

---

Governments Would Disclose Information on Tax Abatements Under GASB Proposal.

Norwalk, CT, October 31, 2014—The Governmental Accounting Standards Board (GASB) issued for public comment an Exposure Draft of a proposed Statement, Tax Abatement Disclosures, which would require state and local governments for the first time to disclose information about property and other tax abatement agreements.

Governments generally agree to abate or reduce the taxes of businesses and other taxpayers to promote economic development, job growth, redevelopment of blighted or underdeveloped areas, and other actions that are beneficial to the government or its citizens. Many state and local governments currently have tax abatement programs in place and the effects of tax abatements on their financial health and ability to raise revenue can be substantial. However, it is difficult to discern the magnitude and nature of those effects from financial statements at present.

The disclosure requirements proposed by the GASB are designed to provide financial statement users with essential information about these programs. Specifically, the proposed tax abatement disclosure requirements would include:

General descriptive information, such as:

- The tax being abated
- Criteria that must be met for the taxpayer to be eligible for the abatement
- Provisions for recapturing abated taxes
- The types of commitments made by tax abatement recipients
- Number of tax abatement agreements
- Dollar amount of taxes abated
- Other commitments made by a government, such as to build infrastructure assets.

“Tax abatements can significantly reduce the amount of revenue a government receives,” said GASB Chair David A. Vaudt. “But in many cases, little is known publicly about their total size or their terms and conditions. What the Board has proposed would make the financial impact of these transactions much more transparent.”

The proposed guidance addresses tax abatements resulting from agreements entered into by the reporting government, as well as those initiated by other governments that reduce the reporting government’s tax revenues.

The Exposure Draft is available on the GASB website, www.gasb.org. Stakeholders are encouraged to review the proposals and provide comments by January 30, 2015.

Visit the Tax Abatement Disclosure Webpage.

GFOA: Talking Points Address Accusations against Pension Plans.

Citing an “urgent goal of saving public pensions amid persistent low funded levels and a burgeoning movement to disassemble them, Callan Investments Institute issued talking points “to move the discussion forward around the importance of DB plans.”

The research paper cites seven points of discussion, and follows with research, data, and actuarial considerations to back each one.

The points include the following: DB plans serve many purposed beyond providing constituents with retirement income; DB plans are proven to be extremely cost effective and reliable in delivering basic retirement income security – when the rules of DB finance are followed; and DB plan funding surpluses and deficits occur as part of the normal cycle of investment market returns.

Read the research paper.

Thursday, October 30, 2014

GFOA: Pensions Help Recruit and Retain High-Quality Workers, Research Finds.

Cutbacks in public pensions could hurt worker quality, as research shows that pensions help recruit and retain high-quality workers, according to a brief from the Center for Retirement Research at Boston College. One indicator of quality is the wage that a worker can earn in the private sector, and by this measure, states and localities consistently have a "quality gap" – the workers they lose have a higher private-sector wage than those they gain, the center's research found. The analysis shows that jurisdictions with relatively generous pensions have smaller quality gaps, meaning they can better maintain a high-quality workforce. Thus, the bottom line, according to the brief, is that states and localities should be cautious about scaling pensions back too far.

Read the brief.

Thursday, October 30, 2014

Looking Under the Hood of Alternative Bond Funds.

Different funds have radically different strategies and management arrangements

The nontraditional bond fund sector continues to attract inflows and new products.

These funds had net flows of almost $25 billion through Aug. 31, according to Morningstar.

Plus, the category is getting more crowded, with 22 new entrants in 2013 and 20 or more additional arrivals projected for 2014, the research group estimates.

A key reason for the appeal of many of these funds is the fact that their flexible portfolios may offer more protection and steadier total returns in a rising interest rate environment than traditional bond funds.

That benefit hasn't been strenuously tested yet, though, as bond yield increases, which were widely expected for 2014, are still on hold. The 10-year Treasury, for instance, dropped to 2% in mid-October.

Surging market volatility is making regulators increasingly concerned that bond funds have loaded up on hard-to-sell assets.

Some funds in this category focus on narrow niches and provide unique strategies, experts point out.

The Forward Credit Analysis Long/Short Fund (FLSIX) focuses on municipal bonds, which accounted for close to 80% of the portfolio as of Sept. 30. Short-term securities (13%) and corporate bonds (7.4%) comprise the balance, with a fraction of 1% in futures contracts.

What makes this fund unique is that it can use strategies to replicate short positions in municipal bonds. According to the fund's materials: "A substantial portion of assets may be invested in

derivatives to seek to achieve returns and for hedging." Additionally, "The fund may engage in borrowing for investment purposes in order to increase its holdings of portfolio securities and/or to collateralize short sale positions, as well as for cash management, and short positions may equal up to 100% of the fund's net asset value."

The hedges are indirect due to the fund's inability to directly short tax-exempt municipals, according to Jim O'Donnell, Forward's chief investment officer.

Portfolio managers can work with Treasury bond futures and the Markit MCDX synthetic municipal-credit index to get around that limitation.

PIMCO is the fund's subadvisor. However, that firm's recent management shake-up doesn't concern O'Donnell, because it hasn't affected PIMCO's municipal-bond managers, who are led by Joe Deane in New York, he says.

The fund uses two benchmarks for comparison: the Barclays U.S. Municipal Bond Index and the Barclays U.S. Corporate High Yield Bond Index.

The returns on institutional shares, from 2009 through 2013, fell between the performance of two indexes, although its 1-, 3- and 5- year performance lagged both benchmarks.

Other Strategies

The Pioneer Absolute Return Bond Fund (ABRDX) takes a different approach that incorporates two strategies.

The portfolio's core component is managed to track the fund's benchmark, the Bank of America Merrill Lynch 3-month U.S. Treasury Index. The fund then uses multiple uncorrelated alpha-generation strategies through selective use of derivatives to seek performance above the core strategy and deliver absolute returns.

These strategies include spread duration, sovereign exposure, interest rates, currency selection and inflation, among others.

The fund takes team-based portfolio management to a new level, according to Pioneer, by utilizing over a dozen analysts and managers with investment responsibility for a particular alpha generator.

For example, one manager handles inflation and Nordic yield curves; another handles volatility, and so on.

The idea behind this approach is to take small amounts of risk across many uncorrelated positions with the goal of adding incremental gains over time. It's a complex management strategy, but a team of portfolio construction-specialists monitors drawdowns and risk levels to avoid extreme positions, says the fund group.

This is the third inception of the strategy for Pioneer, which launched the euro version in December 2010, the British-pound version in December 2013 and the U.S. dollar fund in January 2014.

According to Morningstar, the fund has just under $20 million of assets, and its return has slightly trailed that of the Non-Traditional Bond index.

By Ed McCarthy, CFP

ThinkAdvisor

October 24, 2014

S&P: Ebola Adds Costs For Health Care Sector; No Rating Impact Yet.

NEW YORK (Standard & Poor's) Oct. 22, 2014– Standard & Poor's Ratings Services does not currently expect any near-term rating actions in the health care sector as a result of the Ebola situation. However, we recognize that preparedness will be an added financial expense for many providers and it is already affecting senior management time and energy.

The current progression of Ebola could take one of at least two tracks, in our view. One, the current spread of the disease could be contained, and the health care sector–and the nation as a whole–could come to terms with the U.S. being exposed to this disease. We currently believe that the financial and credit impact would likely be modest and incremental in this case. Two, the Ebola outbreak could continue to spread, in which case we believe the sector will likely respond in ways not yet determined. The financial effects and resulting credit impact, if any, under the second scenario cannot be known at present. However, we believe that the following issues would be relevant credit considerations if the issue were to progress along the second track:

- What additional costs will be required in equipment, training and protocols for patients who present with Ebola or suspected Ebola? Will hazardous waste disposal problems emerge? Who pays for it? Is the cost borne by each individual hospital, the local government, or will federal dollars be available?
- Will hospitals face a stigma from treating patients, potentially driving other patients away from the facility?
- Similarly, will an Ebola stigma create personnel shortages of nurses and other health care professionals if they choose not to be present if Ebola patients show up at their facility?
- If providers are forced, or choose, to forego business as they manage this disease, will business interruption insurance cover these costs? Will there be lawsuits for deaths and the potential spread of the disease? Will malpractice costs go up?

While the Ebola situation is dominating the headlines, there are many other public health issues, such as the flu, that we believe already have a bigger impact on overall morbidity and mortality in the U.S. Indeed, annual fluctuations in flu severity impact reported hospital patient volume trends with possible implications for profitability.

Standard & Poor's will continue to monitor Texas Health, where to date two health workers contracted the disease, as well as other health care providers and other health-related for-profit entities for any immediate financial impact, both positive or negative. For example, a handful of selected health-related suppliers in the for-profit space could experience a spike in

demand, especially those that provide protective gear. However, we expect the incremental costs related to Ebola preparedness will be but one more cost pressure on U.S. providers, and one more factor contributing to our view on the credit quality of health-care providers.

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 Analyst:
Martin D Arrick, New York (1) 212-438-7963;
martin.arrick@standardandpoors.com

Secondary Contacts:
J. Kevin Holloran, Dallas (1) 214-871-1412;
kevin.holloran@standardandpoors.com
David P Peknay, New York (1) 212-438-7852;
david.peknay@standardandpoors.com
Lucy B Patricola, CFA, New York (1) 212-438-3006;
lucy.patricola@standardandpoors.com
Joseph N Marinucci, New York (1) 212-438-2012;
joseph.marinucci@standardandpoors.com

Media Contact:
Alex Ortolani, New York 212-438-5054;
alex.ortolani@standardandpoors.com

MMA Municipal Issuer Brief - October 20, 2014 - Local Pensions as Problematic.

Read the Brief.

Does "Pay for Success" Actually Pay Off? The ROI of Social Impact Bonds.

The concept of Social Impact Bonds is so popular in many circles that politicians believe that they can score points when they make SIBs part of their campaign platforms. Winnipeg mayoral candidate Paula Havixbeck pitched SIBs as "a new tool that other countries have had tremendous success with." The press report didn't identify which SIBs Havixbeck might have cited as tremendous successes, given that none of the handful of SIB demonstrations has reached any point of financial or program success, though some may in the end do so.

Established politicians have latched on to the concept, too. In Chicago, Mayor Rahm Emanuel announced an ambitious program of social impact bond financing to enroll more children in pre-K classes. The program, to be launched next month, would get 2,600 children into half-day preschool classes over four years. The SIB targets would be met with payments for each pupil who, after pre-K, does not get placed in a special education program ($9,100 per pupil), is deemed ready for kindergarten after pre-K ($2,900), and scores above the national average for third-grade reading ($750).

SIBs are also the cloak of respectability sought by some wealthy investors, or so some SIB pitchers believe. In the Huffington Post's "Impact" page of contributed articles, Sharon Foulston, who describes herself as "founding a Social Impact Bond to finance a home for single mothers," a "Business Angel for many years mentoring and investing in entrepreneurs," and interested in "the mystical world of Tarot," offers a creative pitch to moneyed people. Pitching her SIB idea to "the second generation of wealth owners, the inheritors of a period of industry and sustained economic growth," Foulston describes those inheritors of wealth as having reached "a higher level of social conscience, seeking rewards far beyond that which mere money can bring."

In a way, it's easy to see the attraction of Social Impact Bonds. At a time when government seems to be doing many things ineptly, from the Department of Veterans Affairs' management of VA hospitals to the Centers for Disease Control's mercurially unreliable protocols and actions against a stateside outbreak of Ebola, SIBs radiate the glow of a public/private panacea that might cure the dysfunction of government—even without evidence that they can do so. Preferring the nomenclature of "pay for success" over the "boring" language of Social Impact Bond, the respected McClatchy-Tribune op-ed columnist Jay Ambrose exudes that these products of "our high-energy, imaginative, entrepreneurial, can-do spirit and charitable impulses" could materially contribute to the possibility that "we will help people out of desperate circumstances, that we will become a society with less disadvantage, less crime, less unemployment."

Why are Social Impact Bonds so popular when their track record is next to nonexistent? The combination of Ambrose, Foulston, and multiple politicians gives the answer. The American populace sees government and politicians as stymied by party divides, but the SIB/PFS concept has garnered the support of politicians across the ideological spectrum, including endorsement from think tanks of the left (the Center for American Progress) and the right (the American Enterprise Institute), with the appearance that these projects risk the moneys of investors rather than taxpayers, and if successful, will save money in virtually any area of public endeavor.

As Ambrose explained the protean potential applicability of SIBs, "A government agency identifies some social dread it wants fixed and then strikes a deal with a non-governmental organization to fix it…[which] will then find investors to fund managers who put together ways to tackle the problem." As an example, the G8 Social Impact Investment Task Force report, released just last month, suggested that social impact bonds, renamed "development impact bonds" for their application in developing nations, could be, if properly structured and targeted, "an innovative way of tackling the social and environmental issues that constrain private sector development and economic growth: tackling issues in education such as literacy and drop-out rates; in health such as sleeping sickness, malaria and other chronic debilitating diseases; and in employment such as training unemployed youth for available jobs."

Looking at Costs

The investors behind the highly touted but still unproven Peterborough Prison social impact bond, aimed at reducing recidivism of short-term male prisoners released from incarceration, were not profit-minded investors, but 17 foundations and charitable trusts that committed £5 million. In the

U.S., the investors behind the Rikers Island project to reduce recidivism are not the "second generation of wealth owners" who had stumbled into "a higher level of social conscience" that Foulston described, but Goldman Sachs and Bank of America Merrill Lynch, banks that most Americans might not characterize in Foulston's words, and in the case of Goldman Sachs, would receive a financial reward from the project if it worked as planned of over 20 percent, but with a guarantee from Bloomberg Philanthropies, boosted to well north of 80 percent.

The role of philanthropy is critical in the U.S. SIB experiments, and not only with Bloomberg's unusual risk guarantee. Even in Chicago's new pre-K SIB, philanthropy plays a important investment and financing role, with the J.B. and M.K. Pritzker Family Foundation taking a subordinate position behind the Goldman Sachs Social Impact Fund and the Northern Trust taking senior roles—meaning that if the project were not to fully pay out, Goldman and Northern get paid first, and if there were anything left, Pritzer might get it. If the project does succeed, it's probably true that the senior loans get paid at a higher interest rate than the subordinate ones. That is similar to the financial structure that Goldman and Pritzker used for a pre-K SIB in Utah.

One gets the sense of foundations in SIBs playing roles that they have long performed through their program-related investments, providing guarantees for private investors such as banks that "risked" construction or permanent financing for various kinds of projects, though those loan guarantees typically supported capital projects such as affordable housing and facility development as opposed to the costs of social programs.

Examples of foundations that have made loan guarantees through program-related investments in recent years include the Rasmuson Foundation, which in 2010 provided credit enhancement through a first loss guarantee for new facility and housing development loans originated in Alaska by nonprofits; the John R. Oishei Foundation's loan guarantee for Buffalo River Fest Park; and the Meyer Memorial Trust's combined grant and loan guarantee for the Freshwater Trust's stream and river restoration efforts in Oregon. In a more recent guarantee, the Kresge Foundation in 2013 gave the Calvert Foundation a $1.25 million loan guarantee toward Calvert's participation in the Woodward Corridor Investment Fund in Detroit, a $30 million effort to finance mixed-income, mixed-use projects in walking distance of the city's downtown core.

Loan guarantees like these PRI investments or Bloomberg's for the Rikers project don't usually involve a cash outlay, but they do put that amount of the foundation's balance sheet at risk should the deal go sour. Somehow, the notion of Meyer Memorial risking tax-exempt foundation resources on the Freshwater Trust or even the Kresge Foundation for the Calvert Foundation's investment in Detroit feels a little more philanthropically authentic than providing guarantees for Wall Street investment banks that have more capital than these philanthropic institutions might ever hope to see.

There may well be types of investments in which social impact bond-like structures might be significant boosts toward testing and financing high-risk solutions to social problems. If the likes of Wall Street were to invest really high-risk money in nonprofit projects like planning money and predevelopment financing, much as many community development intermediaries and some foundations do in the form of "recoverable grants," that would significantly propel nonprofits to do things that they otherwise cannot, given limitations in governmental funding. However, at least at the outset of the SIB social experiment, the projects in the first wave of SIBs seem to be occurring in areas where the techniques for success have been well demonstrated without SIBs. In reading the information on sites such as the Federal Reserve Bank of San Francisco's "What Works for America's Communities," the U.S. Department of Education's What Works Clearinghouse, and the Urban Institute's What Works Collaborative, as well as Lisbeth Schorr's groundbreaking 1988 book Within Our Reach, much of what is needed in our society is known and available—the obstacle is the

lack of sufficient political will to put public capital behind these strategies and projects that really can make breakthrough changes in social conditions. The evidence that paying private investors such as Goldman Sachs a premium in the form of a SIB will lead to that missing public will is not yet visible.

The prospect of private sector pump-priming capital investment plus the promise of governmental savings add up to a strategy that SIB supporters hope might break the logjam of public sector inaction. However, the pump-priming process at this stage of the nation's understanding of social impact bonds is a bit topsy-turvy. Rather than having Goldman Sachs and other private investors take high-risk positions to demonstrate the concept, the private investors and various SIB financial packagers are looking for government to put money behind incipient SIB efforts to demonstrate "proof of concept."

The various recent public investments geared to pay for consultants and other costs associated with structuring SIB/PFS show multiple funding sources. For example, the Salt Lake County Council just voted to give Third Sector Capital Partners $150,000 from its regional development budget to figure out its next pay-for-success project. In this instance, however, it isn't that Salt Lake knows what it wants to do as its next SIB following its experience with its first, a pre-K project, but it is taking the money for Third Sector from its regional development budget to figure out what social problem to take on next.

Social Impact Bonds are not actual bonds, but a financing mechanism in which private capital finances the implementation of a program, repaid if the program reaches predetermined achievement goals. In Richmond, California, to finance housing rehabilitation efforts, the city is issuing actual long-term municipal bonds paying low interest rates (in contrast to the return on investment anticipated by SIB investors such as Goldman Sachs). The bond will be underwritten by RBC Capital Markets, the Canadian investment bank, and will probably be issued at the city's AA- credit rating. Wells Fargo and Bank of America have been identified as potentially interested investors in the bond. It isn't quite clear how a municipality's decision to issue housing bonds is all that new, given the long history of states and cities issuing mortgage revenue bonds and multifamily housing bonds.

Legislation in front of Congress right now, H.R. 4885, the Social Impact Bond Act co-sponsored by Indiana Republican congressman Todd Young and Maryland Democrat John Delaney, would provide $10 million for states toward the cost of Social Impact Bond feasibility studies and additional federal moneys toward the costs of third-party SIB evaluations. With an array of other federal legislators who have subsequently endorsed the bill, ranging from Jared Polis (D-CO) and Joseph Kennedy (D-MA) to Dennis Ross (R-FL) and Aaron Schock (R-IL), the Social Impact Bond Act exemplifies the bipartisan nature of support that SIBs attract, even with calls for increased funding. But when it comes to the technical assistance and evaluation costs that would typically be wrapped into the overall PFS/SIB financing structure, this legislation puts government into the position of paying for and subsidizing the costs that the SIB structure should in theory cover.

Although conservatives have been highly critical of many of President Obama's social program initiatives, there was no noticeable Republican criticism when, on October 1st, the Social Innovation Fund in the Corporation for National and Community Service announced eight grants for a total of $12 million to launch pay for success initiatives. Each of the grantees will receive between $200,000 and $1.8 million a year over three years, with a dollar-for-dollar match. Grant recipients include entities that will structure and provide technical assistance to SIB/PFS projects, such as the Nonprofit Finance Fund ($3.6 million), the Harvard Kennedy School Social Impact Bond Lab ($1.93 million), and the aforementioned Third Sector Capital Partners ($1.9 million). It is striking that the SIF program theory is that federal front-end predevelopment financing is needed for programs with

strong evidence-based track records, such as the projects often selected for SIB/PFS efforts in the U.S., and for major investment groups with substantial histories of project financing. This kind of front-end planning and development money is much less available to smaller, community-based nonprofits testing unproven program models rather than large, powerful nonprofits with major private financial partners along the lines of the typical SIF/SIB/PFS grantee.

Whatever the specific SIB structure, government is always on the hook to pay for "successful" SIBs, in that the government take-out for the project having reached predetermined goals is key—except that it involves government take-out plus a solid return on investment. It means that government has to appropriate in advance the funds that will pay the investors the costs of their working capital plus their anticipated rate of return, else investors might wonder whether a future legislative body might actually appropriate the funds promised by a previous legislature. For example, Massachusetts has had to allocate up to $27 million for its anti-recidivism SIB. Private investors (banks and foundations) have put $18 million into the project, but anticipate payments of five percent for senior loans and two percent for junior loans if the project is successful. Ostensibly, long-term costs to government are reduced by the savings from avoiding re-incarceration, but government does have to pay at some point. Programs that could and perhaps should be paid for by government without the necessity of a SIB to attract private investors, such as Utah's pre-K SIB, defy logic. Why should government appropriate funds up front to pay investors' costs when the concept of pre-K is proven, desirable, and broadly supported by voters and legislators?

These social programs are rarely so discrete that they can be separately financed by private investors without government playing a role at the very beginning as well as at the end. For example, the Chicago pre-K SIB requires not only upfront private investment, but $4.5 million in state grants and $10 million in city capital funds. The capital expenditure is necessary, we would guess, because there currently aren't enough pre-K spaces in Chicago for the desired SIB pre-K population. A Goldman Sachs representative, Andrea Phillips, said, "Innovative models like social impact bonds and Pay for Success programs allow the private sector to provide the capital needed to expand successful initiatives in our cities and communities, shifting the risk of achieving targeted outcomes away from the taxpayer and enabling governments to pay only for what works," but the reality is that the success of SIBs depends on government investment prior to the SIB project, during the SIB to pay for costs that the investors can't or won't, and after the SIB project once government has to ante up a payment for program costs plus a return on investment.

The public hears about private capital investment, senses governmental dysfunction as of late, and quickly finds the Social Impact Bond concept alluring even while few people know what it really is or whether it will truly save money. Voters might be surprised to learn that government has to be prepared to pay—and pay handsomely in some cases—for having allowed private investors to invest money in projects and concepts that are already well known to work. Why wouldn't the public invest in pre-K, supportive housing, and anti-recidivism projects on their own merits? Do voters need the validation that comes from having Wall Street bankers bless the projects? We suspect that few people understand the levels of government appropriations that might be needed to support PFS/SIB projects both during their implementation and after they are completed and deemed successful—or that government might be needed to provide some up-front SIB project costs.

The queue of potential intermediaries offering their services in structuring and assisting SIBs is out there, is increasing, their motivations probably a mix of commitment to the social issues to be addressed by SIBs—at least we hope so—plus a large dollop of financial expectations for their own bottom lines. For some SIB adherents, their interest in PFS/SIBs is embellished by a strong sentiment that government is unaccountable, uninterested in results, allergic to evaluation and feedback, and largely unproductive. Their ideological predisposition against government seeps out

in various settings when they declare, perhaps with unintentional honesty, that half of government programs have never succeeded with measurable results in any social program endeavor—ever. Some people may even imagine that social investors are somehow more enlightened human beings than the public servants who do the public's work in city, state, and federal agencies. Among a segment of social entrepreneurs of late, there is a growing antipathy toward government—even as they seek out government subsidy.

There are, however, people who truly believe in the efficacy of social impact bonds, even while they acknowledge that there is much to be done to hone the concept to make it practical. Representative Joseph Kennedy III, a co-sponsor of the Young/Delaney legislation, wrote what seems a heartfelt plea for support for the legislation and for SIB models such as the Massachusetts anti-recidivism project being carried out by the Chelsea-based nonprofit Roca. But even Kennedy falls prey to the idea of barriers between the public and private sectors that SIBs can overcome. A team of Brookings Institution researchers recently concluded, "While there is still much to learn in designing and implementing social and development impact bonds, early experiences are somewhat promising in that, at the very least, they have gotten the bureaucrats, the investors and the providers of services to the same table and with aligned interests at that." It is sort of an imaginary world view, in which these observers imagine government as somehow immune from doing the bidding of private sector interests, as opposed to the typical role of politicians feeding tax subsidy upon tax subsidy to private corporations and succumbing to the political process dominated by direct and indirect corporate campaign contributions.

There are important roles for private capital to leverage—or be leveraged by—public funding, especially if the corporate funding boosts the capacity and access to working capital of nonprofits tackling issues that don't come with ready-made, proven solutions and truly need high-risk capital. But if the programs are known to work, as many have been demonstrated to do before the concepts of "pay for success" or "social impact bonds" ever entered the public policy lexicon, it seems so much more logical for government simply to pay for the programs to get them done and not add returns of 7, 10, 20, or 80 percent to attract Wall Street investors. And if the challenge now is to devote government money to the front-end costs of putting together investor-financed SIBs, as Salt Lake County, state governments, and the Social Innovation Fund are now doing, the process is headed in the wrong direction. The nonprofit sector needs feasibility, planning, and predevelopment financing, not big Wall Street investors or the financial intermediaries that anticipate solid paydays from the PFS/SIB concept.

WRITTEN BY RICK COHEN FRIDAY, 17 OCTOBER 2014 14:05

When Public Employees Won't Budge on Their Benefits.

Philadelphia and its teachers are at war over health-insurance costs. Tens of millions of dollars the schools want are at stake.

How bad can a school system's finances get? Probably not much worse than Philadelphia's, whose near-perpetual fiscal crisis almost prevented the city's schools from opening on time in each of the last two years. Now a nasty fight over health-insurance costs between the commission that oversees the schools and the city's teachers' union is writing the latest chapter in the nationwide effort to rein in exorbitant public-employee benefits.

The Philadelphia schools' financial problems are longstanding The state took over the system in

2001, and it is currently governed by a School Reform Commission (SRC), three of whose five members are appointed by the governor and two by the mayor.

Nearly all the stakeholders have pitched in to help address the district's financial shortfalls. The city added a percentage point to its sales tax and $2 to the price of a pack of cigarettes to help the schools, and some of the school district's unions granted concessions.

The one exception is the Philadelphia Federation of Teachers (PFT). Earlier this month, the SRC voted to cancel its contract with the union and force its members to contribute to the cost of their health insurance. The PFT sued, and this week a state judge granted a preliminary injunction to stay all changes to the health plans. The district plans to appeal the injunction and fight another day on the question of whether the SRC acted within its rights when it canceled the contract and imposed new conditions.

PFT members currently contribute nothing to the cost of their health insurance. Under the SRC plan, members earning less than $25,000 annually would pay 5 percent of their health-insurance premium, those making between $25,000 and $55,000 would pay 10 percent and those who earn over $55,000 would contribute 13 percent. The average Philadelphia teacher, who earns $72,000, would pay $932 per year.

In 2013, the opening of school was threatened when the school district faced a $50 million shortfall even after laying off thousands of employees. (The district ultimately borrowed the money and reversed some of the layoffs.) This year the funding gap was $81 million. In each case, the shortfall would have been largely or completely eliminated by the health-insurance contributions, which are estimated to save between $60 million and $100 million annually — resources that are desperately needed in the city's classrooms.

No one can lay the blame for Philadelphia's school-finance crisis at the feet of the PFT. It is a far bigger problem that will require fundamental structural changes in how the city and the state fund schools. But the days of public employees — or anyone, for that matter — paying nothing toward their health-insurance costs are numbered, and rightly so. State and local taxpayers shouldn't be asked to subsidize a public-employee perk that they themselves can only dream of.

GOVERNING.COM

BY CHARLES CHIEPPO | OCTOBER 24, 2014

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.

Changes in Consideration. 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.)

Changes in Scope. 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.

Gains and Losses. 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.

Off-Market Terms. 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

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

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.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING 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.

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

Disclaimer: This Alert has been prepared and published for informational purposes only and is not offered, nor should be construed, as legal advice. For more information, please see the firm's full disclaimer.

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.

Copyright © 2014 by Ballard Spahr LLP.
www.ballardspahr.com

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.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING 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.

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.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING 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.

© Entire contents copyright 2014 by InsuranceNewsNet.com Inc. All rights reserved. No part of this article may be reprinted without the expressed written consent from InsuranceNewsNet.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.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING 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.

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.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING 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.

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

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com