THE WEEKLY MUNICIPAL PERSPECTIVE

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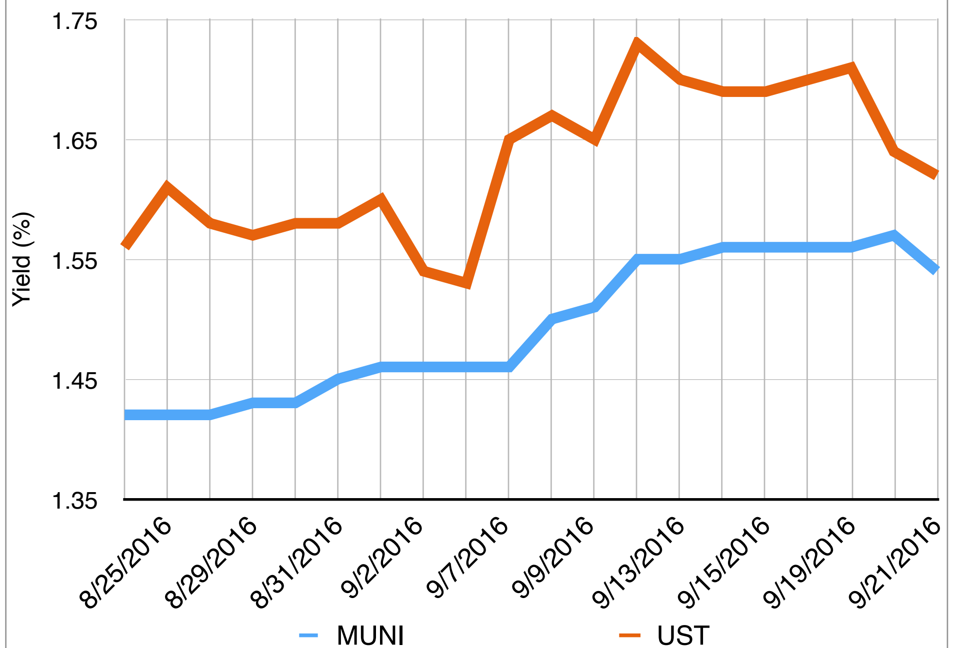
Next Week's Key Deals:

- $757 million general obligation bonds in four series for the state of Hawaii, rated Aa1/AA+/AA. The bonds are scheduled to mature from 2019 through 2033 in 4 series of new-money and refundings. Citigroup is the lead manager for this sale slated to price September 29th. A credit review for the state is on page 4.

- $576 million lease revenue bonds for the State Public Works Board of the state of California rated A1/A+/A+. The bonds are scheduled to mature from 2020 through 2034. A retail order period will be help on September 27th with institutional orders the following day. Wells Fargo Securities is the lead underwriter.

This past week rates worldwide hinged on Wednesday's monetary policy decisions from central banks in the U.S. and Japan wherein both nations did not raise target rates and eased investor concerns about near-term rate volatility. As a result, the market took back losses from the previous five trading days.

Municipal benchmarks did not see the same type of rate volatility — no surprise — but did begin to move into lower-yield ranges as Treasuries rallied on the news.



Rates moved sub 1.7% for Treasuries after the FOMC announcement on Wednesday, an important trading technical barrier. Municipals saw relative value swing by staying still for most of the week although a bid was found in the latter half.

MARKET TECHNICALS/FUNDAMENTALS:

- **Something to consider:** The latest Fed data on municipal bond ownership was released earlier this week that showed the universe of outstanding municipal debt growing 0.55% to $3.82 billion, which is not a surprise given the pace of new issuance this year. Of note, individual ownership fell $15 billion as retail does not reinvest or trades out of the sector due to low rates or interest in managed investment vehicles. That's where the growth in mutual fund ownership and ETFs likely benefited. Bank ownership continues to surge as the 2nd quarter data shows a jump of 3% to $524 billion making this segment the third largest owner of municipal securities.
- Municipal securities were on hold for the first part of the week as far as Benchmark movement ahead of the the FOMC decision on Wednesday. Still, many of the larger deals of the week opted to sell ahead of the decision and we continued to see over-subscriptions on several of the single-A to double-A healthcare credits along with strong interest in the utilities sector.
- Secondary selling pressure remains elevated, which has counteracted the 50th straight week of mutual funds to a certain extent but most importantly allowed the municipal market to largely ignore the Treasury rally on Wednesday post-FOMC decisions. Some of that slack was made up on Thursday and Friday when the bid-side resumed, most notably for the high-grade California sector (looks good for California Public Works next week).
- We made note of New York Dormitory Authority's decision to roll the dice and sell competitively post-FOMC in our write-up last week. Looks like that decision paid off as the deal saw strong bidding in-line or a tad more aggressive than prevailing secondary market rates.

INDUSTRY FOCUS:

The pension and post-employment benefit issues that won't go away whether you are an employee, investor, local financial official or taxpayer was discussed in a story in the *New York Times* last weekend has focused mainstream attention on the different ways of accounting for these liabilities, specifically the issue of market versus actuarial valuations for calculating pension liability requirements for California's units of local government.

The focus of the story was a small, six-employee municipal district that wanted to shift out of the state retirement system – CalPERS – and convert their employees to a 401k system. That switch would have required the district to pay CalPERS an amount of money to fund a termination pool so that sufficient funds would be available for remaining fund participants.

The Problem: Despite the district's calculation that its pension liability was overfunded, it soon discovered that the costs of terminating from CalPERS was much larger than it had assumed. Why? The difference results from the method used to determine a liability — the actuarial approach (which is geared toward helping employers plan stable annual budgets, as opposed to measuring assets and liabilities), and the market approach, which CalPERS uses.

The Impact: This method of calculating a liability underscores the difficulty municipal issuers are having to terminate defined benefit plans even during a strong bull market.

We decided to look at the data assembled by Stanford Institute for Economic Policy Research to see how California's cities and districts rank. Stanford calculates both the market values and the actuarial pension values for 1,068 units of government. It then determines a per-capita liability for each jurisdiction.

The calculations are relevant for investors considering the number of California cities facing large liabilities that could possibly wind them up in bankruptcy. The entity in the worst position is the southern California suburb of Irwindale, at $134,000 per capita. San Francisco is fifth worst at $47,288 per capita. Beverly Hills was seventh worst at $42,056. Los Angeles was 13th at $26,847. San Jose was 29th at $19,908. Many prominent issuers, including Los Angeles County, the cities of Bakersfield and Oakland, and a number of the larger school districts in the state, are unfortunately not in the list.

Generally considered the poster child for pension liabilities is San Bernardino, which was well down the list, coming in 55th at $17,027 per capita. The city, which recently concluded four years of operations under Chapter 9, will hold a critical hearing to consider confirmation of "Third Amended Plan for the Adjustment of Debts of the City of San Bernardino" on Friday, October 14, 2016. If finally approved, the City will have reached agreements to adjust general obligation debt and unsecured pension debt (under agreement with creditors) with its obligation reduced from $95.8 million to $50.7 million. The city will also achieve an estimated total of $60 million in cost savings related to employee healthcare.

CSG's thinks ahead to the next recession and how market values of liabilities will sink even further when market volatility arises. Within this context, we suggest investors think carefully about the treatment of bondholders should another wave of Chapter 9 filings arise.

SHIPPING BANKRUPTCY SHOULD NOT IMPACT U.S. PORTS

It has been said that eventually, every significant national issue will somehow touch the municipal bond market. The latest example of this relates to the recent bankruptcy of a South Korean shipping giant, Hanjin, setting off pandemonium in container trades. Reports emerged Thursday of soaring spot market rates on both the transpacific and Asia-Europe trades, and more worryingly, vessels are being prevented from berthing or unloading at ports across the globe.

Hanjin is a major player at many U.S. ports which frequently issue revenue bonds and plan to spend a whopping $154.8 billion on port-related freight and passenger infrastructure over the next five years. Los Angeles and Long Beach continue to dominate the sector with Los Angeles planning to invest $2.6 billion in the coming decade, and neighboring Long Beach is in the midst of a 10-year, $4.5 billion capital expansion program. These and other ports are in a race to prepare for the new generation of ships with a capacity of 18,000 20-foot-equivalent units or greater.

The sudden announcement left dozens of ships literally stranded at sea around the world, 14 of which were bound for U.S. ports. Some of the stranded ships have been turned away by ports that are fearful

their dockworkers won't get paid. Others have been seized by authorities, with crews prevented from disembarking.

What will the impact of this be on US ports? CSG believes this should not be an issue for U.S. ports and their revenue bonds. Given the dire straits in which container shipping industry finds itself in the current environment, a temporary removal of Hanjin's ships from operation will provide a much-needed boost to other shipping companies. Most sector analysts believe the most likely outcome of Hanjin's predicament is that its assets will be liquidated and acquired by multiple carriers. The resulting improved freight rates during liners' busiest quarter when retailers prepare for the Christmas season will be a plus for the third quarter results of container liners.

Additionally, in the aftermath, a U.S. judge issued a court order allowing some vessels to dock at U.S. ports without the risk of being seized by creditors. The company received authority to spend money needed to dock at U.S. ports and begin unloading four vessels that have been stranded at sea last week.

INVESTOR CORNER:

State of Hawaii

Security: General obligation pledge of full faith, credit and a priority on all general fund resources.

Size: $757 million in four series.

Purpose: New money (Series FG and Taxable Series FJ) and refunding (Series FH and FI) will be used to refund outstanding bonds for debt service savings.

With this new issue, Moody's raised Hawaii's $6.4 billion general obligation bonds outstanding to Aa1 from Aa2. The outlook on these ratings is stable. The upgrade reflects the state's "positive economic and revenue trends, the restoration and maintenance of sizable reserves, and proactive measures to improve the funding of its pension and OPEB liabilities." Moody's points to the state's OPEB contribution, which was more than the statutorily required amount in fiscal years 2014 through 2017, and is likely to meet or exceed the ARC in 2018.

Offsetting the above strengths, Hawaii's fixed costs rank highest in the country due primarily to the state's responsibility for financing K-12 capital needs.

Led by tourism and construction, state Gross Domestic Product (GDP) growth will continue for the seventh consecutive year. As the chart (right) indicates, Hawaii remains in very good shape looking forward.

Percent Growth Rates (%)	Forecast 2015	Forecast 2016
Visitor Arrivals by Air	+4.0%	+2.0%
Nominal Visitor Spending	+3.0%	+3.0%
Construction Completed (Tax Base)	+10.0%	+12.0%
Total Jobs	+1.4%	+1.6%
Unemployment Rate	3.8%	3.2%
Real Personal Income	+2.3%	+2.5%
Inflation (CPI-U)	+1.0%	+2.0%

Source: Dr. Jack Suyderhoud