THE WEEKLY MUNICIPAL PERSPECTIVE

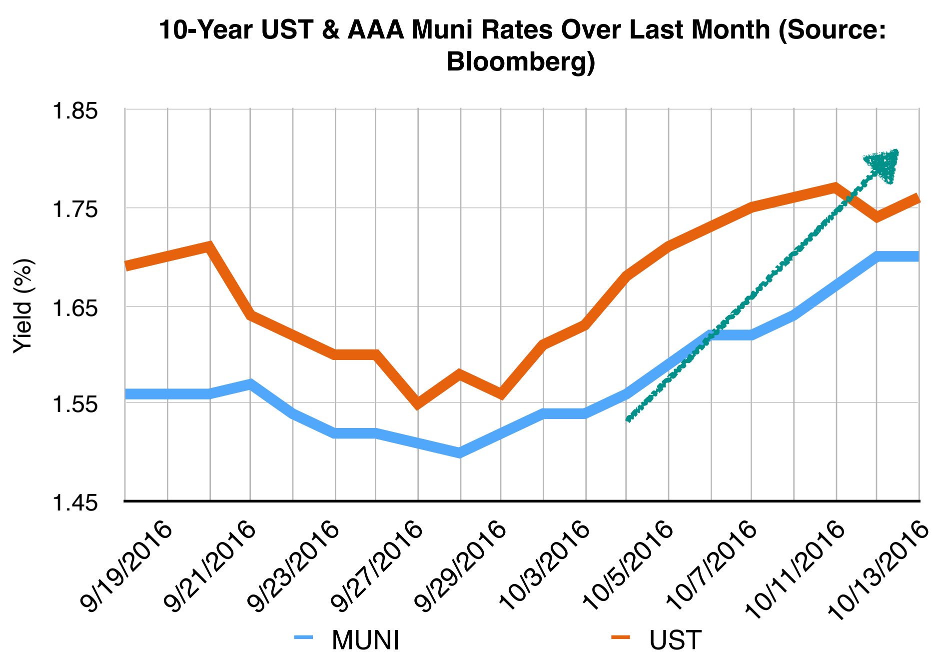
MATT POSNER | BOB DONAHUE | JOSEPH KRIST

Next Week's Key Deals:

- $1.64 billion of tax-exempt and taxable various purpose general obligation bonds for the state of California, rated Aa3/AA-/AA-. The state will sell $255 million of taxable GOs and $1.39 billion of tax-exempt GOs competitively on Tuesday, the 18th.
- $1 billion of Robert Wood Johnson Barnabas Health Obligated Group corporate revenue and refunding tax-exempt and taxable bonds for the New Jersey Healthcare Financing Authority. Series A, $612 million of tax-exempt revenue and refunding bonds, are rated A1/A+/NR. $456 million of taxable revenue bonds are rated A1/A+/NR. Lead underwriter is Citigroup Global Markets Inc.
- See more color on the market for these deals on the next page.

This past week continued to see U.S. fixed income rise into higher yield ranges as a result of Fed posturing. After Wednesday's release of the Fed minutes showing that the Central Bank was closer than many thought to raising rates, we saw further losses. On Thursday the Benchmark 10-year rate hit 1.8%, which made for a relief rally, but the damage has been done to confidence.

Municipal benchmarks also continued to move into cheaper ranges and there are negative underlying technicals here to consider, **discussed below**. Still, rates are near historic lows and issuers continue to take advantage.



Heightened concern about the next Federal Reserve move, plus international data-sets, forced most fixed-income markets into higher ranges. Municipals largely moved into higher yields in lock-step.

Policy Corner

MUTUAL FUND RULES:

On Thursday this week the Securities and Exchange Commission (SEC) voted on a rule that would change the liquidity rules for mutual funds, including those that invest in municipal bonds.

The rules requires funds to re-assess the liquidity of the municipal bond holdings and have a larger cushion of cash to manage for situations in which there is extreme liquidity.

CSG Research has maintained that these rules will increase the cost of investing in a mutual fund as these entities have extra diligence procedures to understand the liquidity of their investments in a different manner.

Nearly a year ago, CSG Research Partner, Matt Posner, wrote an opinion column on the impact of such rules wherein the details of the impacts can be reviewed. You can read that by clicking here.

While managing liquidity is paramount to investor confidence in the mutual fund complex, these set of rules are overly burdensome and should have been altered.

MARKET FUNDAMENTALS & TECHNICALS:

•**Something to consider:** The volume of bonds offered for a bid touched the $20 billion mark on Wednesday this week, according to Bloomberg's PICK metric — a level rarely seen. This line has been crossed four times in the last three weeks, but before that, it hasn't been touched since 2014. The volume on PICK is an indicator of macro selling pressure in the municipal space. That it has been so high of late means a lot of investors are attempting to exit the marketplace through a door that isn't large enough.

•It isn't just secondary selling pressure noted above; new-issue supply has been massive of late. At $19.466 billion, today's 30-day visible supply from The Bond Buyer nears the yearly high of $21.579 billion, which was touched on October 5th. This coming week looks to top $13 billion and will likely be the largest of the year.

•Healthcare credits, which have seen an increase in issuance this year (year-over-year up nearly 30% compared to 2015), have been underperforming of late. This week Charlotte-Mecklenburg Carolinas Health had to cut prices modestly to get the deal done. How next week's New Jersey Health Care Finance Authority Robert Woods Hospital deal fares will be a test for this important sector in the marketplace.

•The state of Illinois successfully placed more than $1 billion of GOs this week. The yields were higher than the last issuance but the state was prudent to take advantage of the current yield-starved environment. Several large international pension funds participated. This buyer segment continues to play a role in the marketplace and will be interesting to see how they respond when the sovereign debt picture changes down the road. In other words — how do they exit their position (if they do at all) when we enter a world where they have other investing opportunities.

•**Looking to next week:** Caution is the theme. The supply, the slowing in mutual fund inflows, the perception that Treasuries are finally moving into a higher range, will put traders on high alert. We'll be watching two competitive deals in particular, $1 billion-plus California GO and a $500 million Georgia GO, for signs of where dealer confidence stands in the marketplace. The comparable for these higher-rated, generally liquid credits will be key to assessing true market conditions.

INDUSTRY FOCUS:

HURRICANE MATTHEW — A REMINDER THAT RISK LOOMS OVER FLORIDA

Hurricane Matthew dominated the news last week and provoked many questions regarding the impact on Florida. Fortunately, the impact Matthew had on the municipal bond market is not anticipated to be material, should be easily managed and will not affect the state's credit rating. The State of Florida has been fortunate in that a hurricane has not made landfall in Florida in 11 years, during which time the state has accumulated a sizable cushion and appears well positioned to deal with the effects of a moderate hurricane season.

With hurricane risk always looming over Florida, in particular CSG keeps an eye on two large municipal issuers: **Florida Hurricane Catastrophe Fund (FHCF) and Citizens Property Insurance Corp (CPIC)**. We offer some brief comments on these below:

- **FCHF,** which reimburses insurers for losses caused by covered events within a given contract year, funds itself through bonds backed by Reimbursement Premiums charged to participating insurers under contracts with the Fund and by Emergency Assessments of 6% of losses during any contract year and up to 10% of aggregate losses. Those funds are invested and the earnings on those investments, along with the premium and assessment revenues, are pledged to the repayment of its bonds. Over the last five years through FY 2015, annual premiums collected by the Fund have been at least $1.2 billion and have created a reported net position of $11.6 billion.
- **CPIC** (A1/A+/AA-) is a Florida State-created, residual market insurer that serves the needs of homeowners in high-risk areas and others who cannot find coverage in the private insurance market. Citizens' approximately $1.6 billion pre-event bonds and $6.8 billion in cash and invested assets provide multi-year liquidity to help ensure timeliness of payment for policyholders after a hurricane event. CPIC's credit previously was clouded by rising market share as private insurers exited the market but these concerns have greatly diminished. Since 2011, its overall policy count decreased by 55% and exposure decreased by 60% (from 460,161 in 2011 to 282,863 as of December 31, 2014) as insurers re-entered the market. Citizens' financial position with claims-paying resources of over $12.4 billion for the 2015 season, as compared to a 1-100 year PML of $8.2 billion.

The impact of the devastation of hurricanes on general government credits is something many analysts remember, with the accompanying loss of business activity, tax collections and enterprise fees. Historically, hurricanes have a serious impact on normal government business and monies available to pay debt service on municipal bonds. Municipal bonds related to the hardest-hit areas are susceptible to missed payments and, in the worst of situations, are left exposed to bankruptcy. These worst case outcomes are likely to be avoided if help is received from the federal government in the form of loosening the restrictions on advanced refunding workout bonds and/or if there is external support from federal, state or other third-party sources.

CHICAGO GETS G.O. OUTLOOK UPGRADE

Two major rating agencies, Fitch and S&P, have upgraded their outlooks for Chicago's finances from negative to stable, with ratings of BBB- and BBB+, respectively. The actions reflect City Council tax increases to address looming pension liabilities. Moody's, the agency that (harshly, in our view) first downgraded the city, still rates the debt below investment grade (Ba1) with a negative outlook. The highly respected Civic Federation called the Mayor's proposed budget "good news" but called for more details on how the recently signed teachers' contract would be funded.

The good reviews reflect support for Mayor Rahm Emanuel's fiscal 2017 budget plan released this week. Among other things, the budget:

- Increases water and sewer rates by 29%, which will be dedicated to municipal employees' fund
- Reduces the projected structural deficit (from $635 million in 2011 to $138 million in 2017)
- Eliminates costs through various efficiencies
- Funds reserve accounts and slowly phasing out "scoop and toss," the practice of pushing off bond principal payments for budget relief.

Chicago plans to seize on the favorable news, issuing $1.275 billion of GO bonds for debt relief. Credit spreads to AAA have tightened roughly 50 basis points in recent weeks. Emanuel is seeking to rehabilitate both the city's finances and his political future — stating this week that he has "every intention of running again" ahead of the February 2019 election.

MIAMI'S $1 MILLION SETTLEMENT

Miami's City Commission agreed to pay a $1 million fine to settle securities fraud claims brought by the U.S. Securities and Exchange Commission, according to documents posted on the city's website. The proposed settlement is said be the largest penalty the SEC has ever imposed on a municipal bond issuer. In a Sept. 22 court filing, the parties said they had reached a tentative settlement, though terms were not then disclosed. The deal was unanimously approved by the City Commission this week.

One-time budget director Michael Boudreaux, however, has not reached a settlement with the SEC. The former budget director remains confident he will be fully exonerated. It is unusual for an enforcement action against a municipal issuer to go to trial and a rare instance of monetary penalties being sought against a municipality. The SEC has in recent years sought to be more aggressive in its regulation of the municipal bond market. Success in Miami will further embolden the agency's efforts, although this marks the second time that the city has been cited for securities fraud.