Private Activity Bonds Workshop
The California Debt and Investment Advisory Commission
Los Angeles, California — September 7, 2011

Loop Capital Markets

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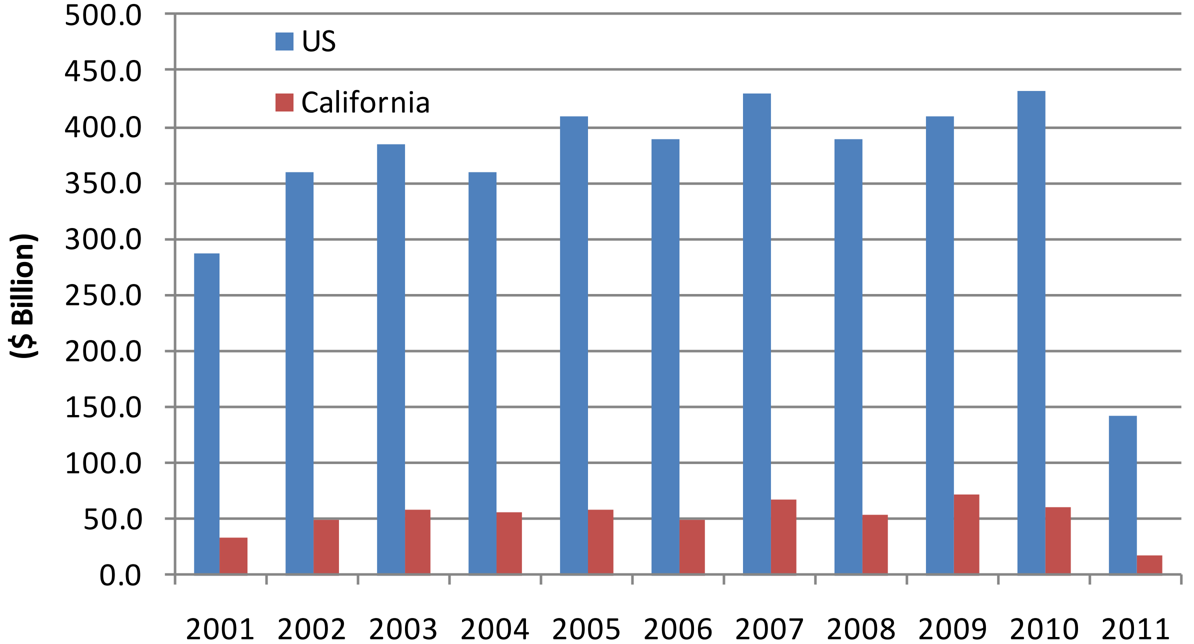
Challenging Time to Raise Capital

- **Uncertainty—the economy, the deficit, international banking, possible Congressional "surgery" on the market, and on and on…**
- **Limited liquidity—will the demand be there for my project?**
- **Debt and deficit debates—not just a distraction, sometimes an obstruction!**
- **Low municipal bond volume—like the honey bees, many muni bond issues have "gone away" in 2011**
- **With rates this low, will investors buy bonds?**

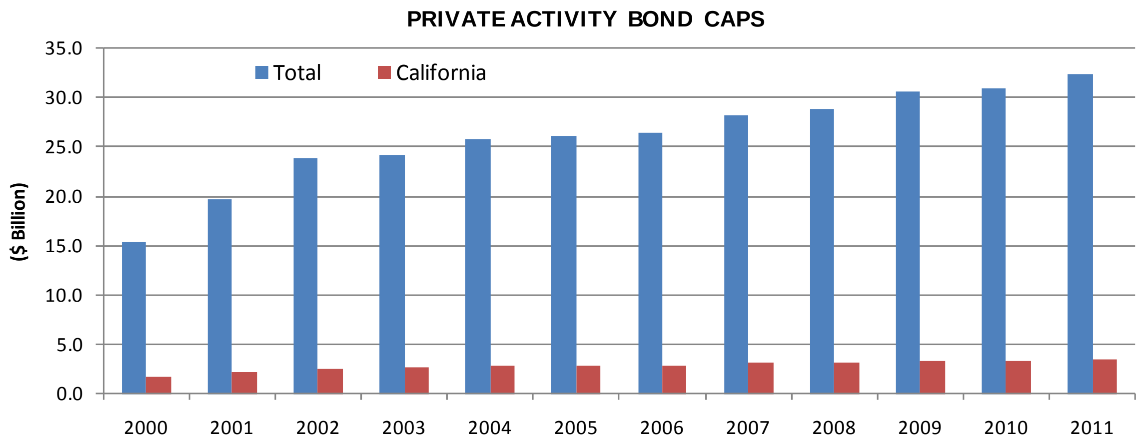
Historical Municipal Bond Volume



Source: The Bond Buyer

- **Year to date, municipal volume is down 39% compared to the same period last year.**
- **California volume is down 46%.**
- **California typically represents from 11.5% to 17.5% of total volume.**

Historical Private Activity Bond (PAB) Volume



UNITED STATES

	2007	2008	2009	2010
		($ Million)		
New Cap	28,184.9	28,571.1	30,251.8	30,503.7
Carryforward From Previous Cap	21,170.3	17,231.1	23,351.1	41,577.7
Extra Housing Cap	0.0	10,500.0	7,386.4	6,227.7
Total Capacity	48,854.2	50,984.2	60,989.3	64,966.6
Mortgage Revenue	9,545.7	3,704.7	3,571.2	4,551.5
Multifamily Housing	5,743.0	1,285.8	1,153.8	2,388.2
Housing (Not Broken Out)	1,983.3	2,488.8	930.3	825.2
Industrial Development Facilities	3,080.8	1,266.3	946.5	665.9
Exempt Facilities	2,661.9	2,577.9	2,352.2	1,802.0
Student Loans	4,423.4	1,547.8	1,368.7	1,110.8
Mortgage Credit	247.1	377.0	1,311.4	2,085.6
Other Bond	559.0	204.5	317.1	1,232.5
Total PABs Issued	**28,244.2**	**13,452.8**	**11,951.2**	**14,661.7**
Total Carryforward to Next Year	16,522.5	32,212.4	41,212.6	43,506.2

CALIFORNIA

	2007	2008	2009	2010
		($ Million)		
New Cap	3,098.9	3,107.0	3,308.1	3,326.5
Carryforward From Previous Cap	402.7	1,848.4	2,090.0	3,000.0
Extra Housing Cap	0.0	1,144.6	1,177.0	955.1
Total Capacity	3,501.6	6,100.0	6,575.1	7,281.6
Mortgage Revenue	421.7	0.0	146.0	60.0
Multifamily Housing	1,023.7	0.0	296.0	349.6
Housing (Not Broken Out)	0.0	1,065.0	0.0	0.0
Industrial Development Facilities	97.7	118.3	20.0	45.0
Exempt Facilities	264.5	385.1	68.0	529.6
Student Loans	210.0	0.0	0.0	0.0
Mortgage Credit	45.2	0.0	300.0	181.5
Other Bond	0.0	0.0	0.0	0.0
Total PABs Issued	**2,062.8**	**1,568.4**	**830.0**	**1,165.7**
Total Carryforward to Next Year	1,438.8	2,700.0	5,743.4	4,318.9

Source: The Bond Buyer

- **Issuance dropped off since 2007 due to the housing downturn. Housing recovery programs rolled out by Obama administration led to an increase in PAB issuance in 2010 which is expected to continue through the end of 2011.**

General Private Activity Bond Rules

- **PAB proceeds are used by one or more private entities.**

- **A municipal security is considered a PAB if it meets either of the two conditions in Section 141 of the IRS code:**
  - More than 10% of proceeds are for private business use and payment of principal and interest on more than 10% of proceeds is secured or payable from property used by private business
  - The amount of proceeds used to make loans to non-governmental borrowers exceeds the lesser of 5% of the proceeds or $5 million

- **Interest on PABs is excluded from gross income for federal income tax purposes if bonds fall within certain defined categories ("qualified bonds" or "qualified private activity bonds") under federal tax laws.**

- **Most categories of private activity bonds are subject to the alternative minimum tax.**

- **The issuance is limited and subject to state volume caps. In 2010, state volume caps were the greater of $90 per resident or $273.8 million, with states determining sub-allocation.**

Types of Qualified Private Activity Bonds

- **Exempt facility bonds—For financing facilities owned or used by private entities**
  - Airports
  - Docks
  - Transportation facilities
  - Water and sewer
  - Local electric and gas utilities
  - Solid and hazardous waste disposal facilities
  - Residential rental projects
  - Enterprise Zone facilities
  - Recovery Zone facilities
  - Other
- **Qualified mortgage bonds—Single family mortgage revenue bonds**
- **Qualified redevelopment bonds**
- **Qualified small issue bonds—For financing manufacturing facilities**
- **Qualified student loan bonds**
- **Qualified veterans' mortgage bonds**
- **Qualified 501(c)(3) bonds—For financing facilities owned or utilized by charitable organizations**

History of PAB Legislation

- 1968, Congress passed the Revenue and Expenditure Control Act of 1968 which established the basis for the current definition of private activity bonds.
- 1988, the Supreme Court agreed to hear a case that changed the nature of the federal tax treatment of state and local government debt.
- 1984, Deficit Reduction Act of 1984, the private activity bond volume limit was implemented.
- 1986, the limit and the list of qualified activities were both modified again under the Tax Reform Act of 1986.
- 2002, Job Creation and Worker Assistance Act of 2002, Empowerment Zones and New York Liberty Zones were established in the wake of the September 11, 2001 terrorist attacks on New York City.
- 2005, Gulf Opportunity Zone Act of 2005. The hurricanes that struck the gulf region in late summer 2005 prompted Congress to create a tax-advantaged economic development zone intended to encourage investment and rebuilding in the Gulf region.
- 2008, The Housing Economic Recovery Act of 2008 added $11 billion of PAB volume cap solely for housing bonds and also laid the foundation for the New Issue Bond Program, which the Treasury Department created in late 2009 to revitalize bond issuance among state and local housing agencies.
- 2009, The American Recovery and Reinvestment Act of 2009 loosened restriction for small issue IDBs, allowing them to be sold for intangible property.
- 2009-2011, New Issue Bond Program was created by the Treasury Department in late 2009 to revitalize bond issuance among state and local housing agencies.

History of PAB Legislation in California

- **The California Debt Limit Allocation Committee (CDLAC) is a three-member body comprised of the State Treasurer as Chair, the Governor, and the State Controller. The 1984 Tax Act also required each state to designate an entity to allocate the state's ceiling among various state and local issuers. CDLAC was created in 1985 by Governor proclamation in response to this act. Private activity bonds included student loan bonds and industrial development bonds (including exempt facility bonds, small-issue industrial development bonds, and bonds for industrial parks).**

- **The 1984 Tax Reform Act**
  - Imposed an annual limit on the dollar amount of tax-exempt private activity bonds that may be issued in a state.
  - The annual limit was derived by multiplying the state's population by $150, resulting in a $3.8 billion ceiling at that time.

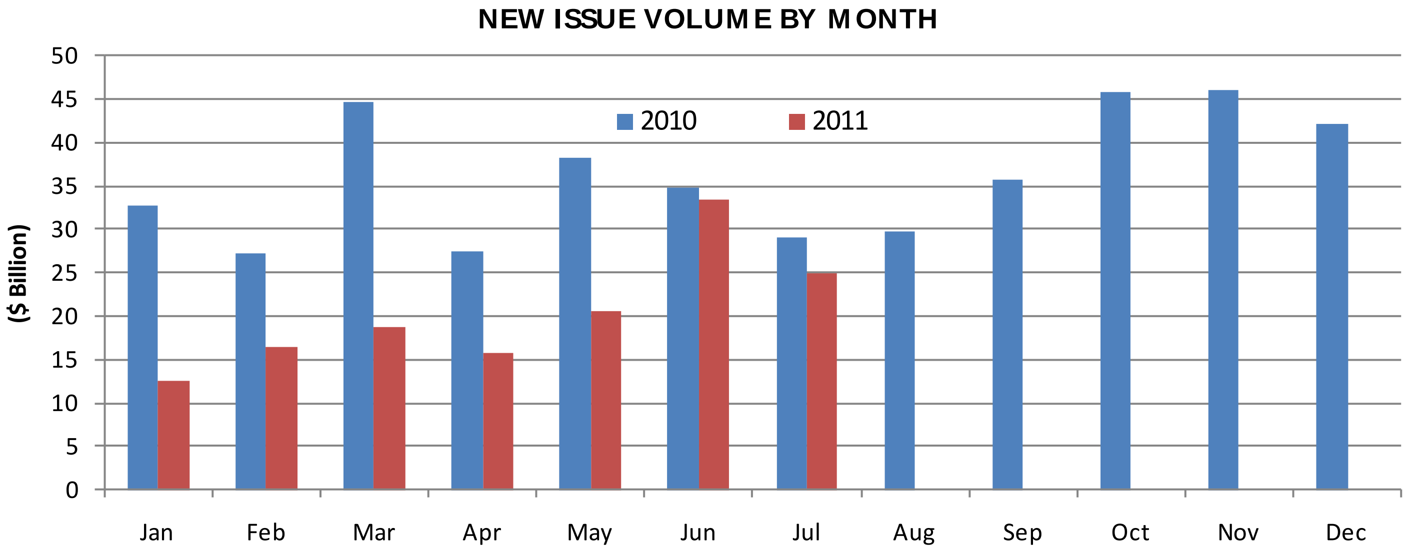
- **The 1986 Tax Reform Act**
  - Reduced the annual volume cap to $75 per capita in 1986 and 1987 and $50 per capita thereafter.
  - The Act also brought bonds for single-family and multifamily housing under the state ceiling. As a result, a new Governor's proclamation was issued in 1986 re-affirming CDLAC as the state's sole entity responsible for allocating the annual ceiling, and expressly authorizing CDLAC to establish procedures and reserve amounts of the ceiling for certain purposes or issuers.
  - In 1987, the California State Legislature statutorily established CDLAC by enacting Chapter 943.

History of PAB Legislation in California

- **The 1998 Omnibus Budget Act**
  - Raised the volume cap on private activity bonds to $75 per capita or a minimum of $225 million to take place incrementally from 2003 through 2007.

- **The Community Renewal Tax Relief Act of 2000** accelerates the scheduled increase contained in the 1998 Act by raising the volume cap to $62.50 per capita of the state's population or $187.5 million, whichever is higher, for calendar year 2001 and $75 per capita or $225 million, whichever is higher, in calendar year 2002 and thereafter. The 2000 Act also allows for the volume cap to be indexed for inflation starting in calendar year 2003.

Precipitous Drop in New Issue Volume in 2011



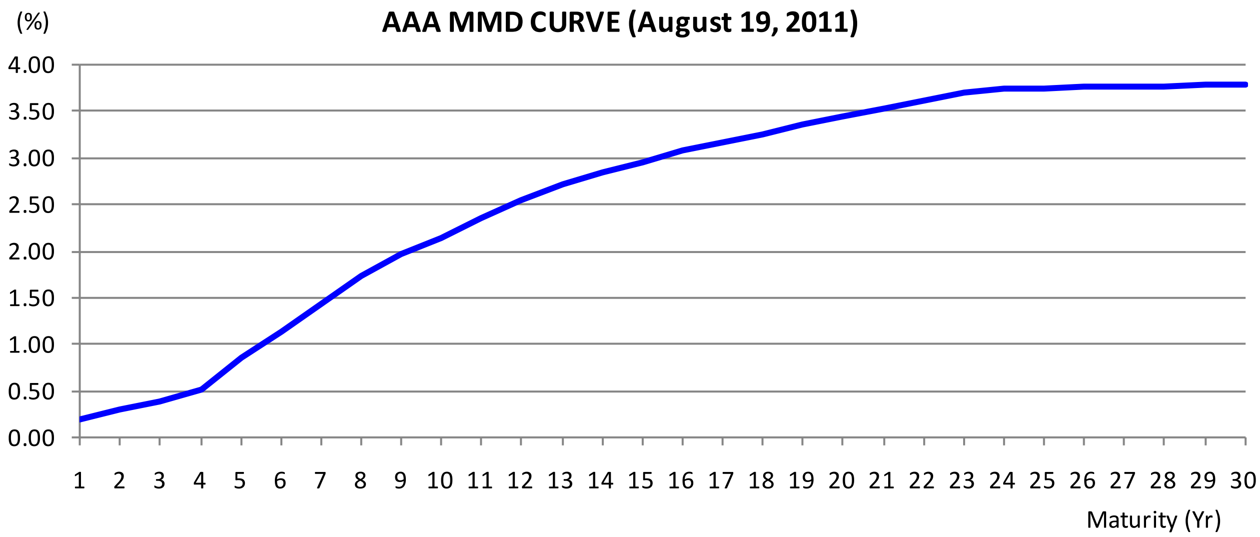
- **We have revised our estimate for 2011 municipal bond volume to $275 billion.**
- **In June and July new issue volume recovered somewhat.**
- **Volume in the last few months of 2010 was boosted by BABs issuance.**
- **Our forecast implies that volume through the rest of this year will be about one third lower than in the same period in 2010.**

Loop Capital’s Volume Forecasting Model

- **Through a multi-variable regression analysis we have determined that the following factors explain about 80% of variability in new issue volume:**
  - 10-year Treasury yield
  - State and local government tax revenues
  - 5-year MMD—Treasury ratio

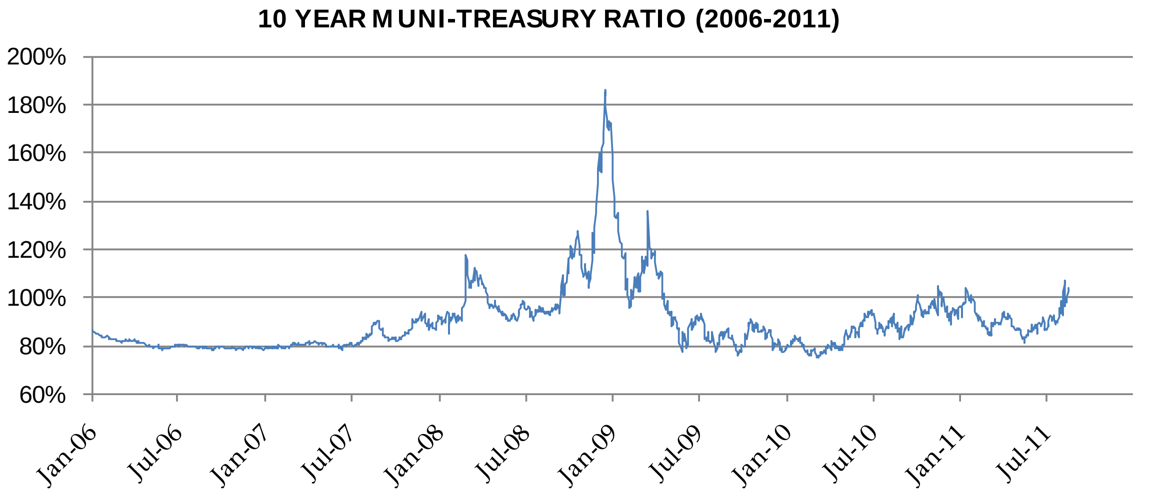
- **In 2011, for the first time, the model was off by more than 8%.**
- **The reason for the unexpected, historic, decline in volume appears to be a very strong political reaction to the status quo. The result of this reaction has been for issuers to bring financing of new and existing infrastructure to a standstill.**
- **Nowhere is this political reaction stronger than in California where the State has postponed issuance of general obligation bonds until the fall, and even that is far from certain.**
- **Whether or not this new political dynamic continues to its current degree is difficult to ascertain. Our tendency is to believe that it will be in place at least until the beginning of 2013—after the general election.**

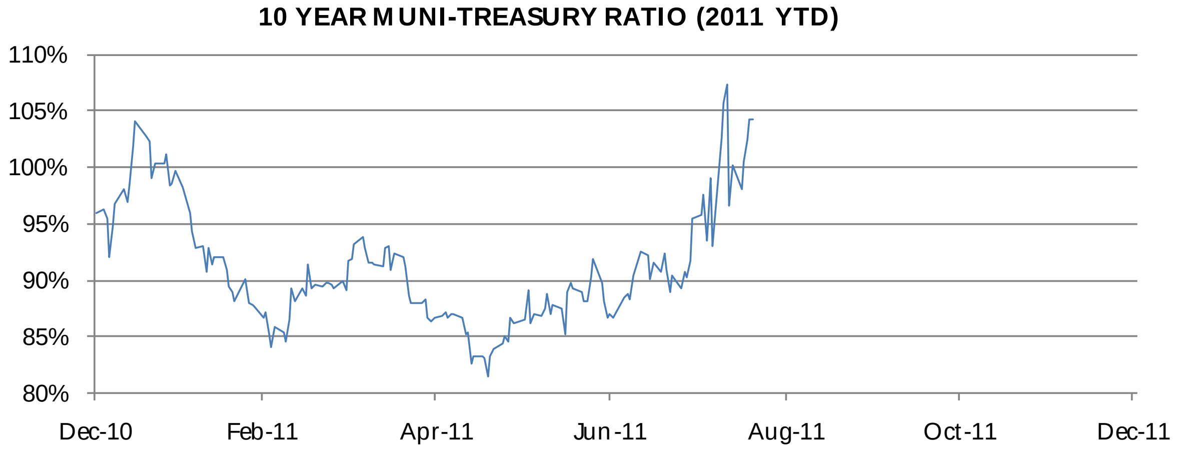
Steepness of the Muni Yield Curve



- **As of the end of July, the 1-30 year AAA MMD spread was 415 bps.**
- **Over the last 30 years, the curve has been steeper less than 5% of the time.**
- **The flight to Treasuries amid market turmoil in early August made munis very attractive on a relative basis.**
- **The long end of the AAA MMD curve fell 56 basis points in August, thus significantly flattening the curve.**
- **1-30 year spread of 359 bps (as of August 19) is steeper than it has been 76% of the time in the last 30 years.**

Muni Treasury Ratio





Indicative New Issue Pricing

	Port of Oakland (California)	Regional Transportation District (Colorado)	City of Long Beach (Calfiornia)
	Refunding Revenue Bonds	Tax - Exempt Private Activity Bonds	Senior Airport Revenue Bonds (Private Activity)
	2011 Series 0 (AMT)	Series 2010	Series 2010 A
	$345.730M	$397.835M	$48.435M
	NEG	NEG	NEG
PRICE DATE	8/4/11	8/4/10	11/2/10
DTD DATE	8/16/11	8/12/10	11/23/10
CALLS	2021@100	2020@100	2020@100
RATINGS	A2/A/A+	Baa3/-/BBB-	A2/-/A-
DUE	5/1	1/15 & 7/15	6/1

Port of Oakland (California)

	COUPONS	INSURER	YIELDS	SPREAD VS AAA MMD	
2012	1.500	Uninsur.	NRO	**NRO**	
2013	1.500	Uninsur.	1.240	**89**	
2013	4.000	Uninsur.	1.240	**89**	
2014	2.000	Uninsur.	1.650	**114**	
2014	5.000	Uninsur.	1.650	**114**	
2015	2.250	Uninsur.	2.030	**132**	
2015	5.000	Uninsur.	2.030	**132**	
2016	5.000	Uninsur.	2.550	**151**	
2017	5.000	Uninsur.	2.940	**156**	
2018	3.375	Uninsur.	3.310	**159**	
2018	5.000	Uninsur.	3.310	**159**	
2019	3.750	Uninsur.	3.670	**164**	
2019	5.000	Uninsur.	3.670	**164**	
2020	5.000	Uninsur.	3.970	**169**	
2020					
2021	4.200	Uninsur.	4.130	**169**	
2021	5.000	Uninsur.	4.130	**169**	
2022	5.000	Uninsur.	4.390	**173**	*
2022					
2023	5.000	Uninsur.	4.580	**175**	*
2023					
2024	5.000	Uninsur.	4.740	**177**	*
2024					
2025	5.000	Uninsur.	4.860	**177**	*
2025					
2026	5.000	Uninsur.	4.950	**177**	*
2027	5.000	Uninsur.	5.000	**173**	**
2028	5.000	Uninsur.	5.080	**172**	**
2029	5.000	Uninsur.	5.110	**166**	**
2030	5.125	Uninsur.	5.130	**159**	**
2031	5.125	Uninsur.	5.200	**157**	**
2034					
2040					
2041					

*** Priced to the call on 5/1/21**
**** Optional call on 5/1/21**

Regional Transportation District (Colorado)

	COUPONS	INSURER	YIELDS	SPREAD VS AAA MMD		Due
2012						
2013						
2013						
2014						
2014						
2015						
2015						
2016						
2017						
2018						
2018						
2019	5.250	Uninsur.	4.850	**249**		**7/15**
2019						
2020	5.250	Uninsur.	5.000	**247**		**1/15**
2020	5.000	Uninsur.	5.000	**244**		**7/15**
2021	5.000	Uninsur.	5.100	**242**	**	**1/15**
2021	5.000	Uninsur.	5.100	**239**	**	**7/15**
2022	5.000	Uninsur.	5.250	**244**	**	**1/15**
2022	5.000	Uninsur.	5.250	**241**	**	**7/15**
2023	5.125	Uninsur.	5.350	**240**	**	**1/15**
2023	5.125	Uninsur.	5.350	**239**	**	**7/15**
2024	5.250	Uninsur.	5.450	**237**	**	**1/15**
2024	5.250	Uninsur.	5.450	**237**	**	**7/15**
2025	5.375	Uninsur.	5.550	**236**	**	**1/15**
2025	5.375	Uninsur.	5.550	**236**	**	**7/15**
2026	6.000	Uninsur.	5.600	**231**	*	**1/15**
2027						
2028						
2029						
2030	6.500	Uninsur.	5.900	**225**	*	**1/15**
2031						
2034	6.000	Uninsur.	6.080	**219**	**	**1/15**
2040						
2041	6.000	Uninsur.	6.130	**217**	**	**1/15**

*** Priced to the call on 7/15/20**
**** Optional call on 7/15/20**

City of Long Beach (Calfiornia)

	COUPONS	INSURER	YIELDS	SPREAD VS AAA MMD	
2012					
2013	3.000	Uninsur.	1.700	**109**	
2013					
2014	3.000	Uninsur.	2.230	**134**	
2014					
2015	4.000	Uninsur.	2.550	**141**	
2015					
2016	4.000	Uninsur.	2.950	**151**	
2017	5.000	Uninsur.	3.290	**155**	
2018	5.000	Uninsur.	3.560	**156**	
2018					
2019	5.000	Uninsur.	3.820	**157**	
2019					
2020	5.000	Uninsur.	4.010	**155**	
2020					
2021	5.000	Uninsur.	4.210	**154**	*
2021					
2022	5.000	Uninsur.	4.320	**154**	*
2022					
2023	4.250	Uninsur.	4.400	**152**	**
2023					
2024					
2024					
2025	4.500	Uninsur.	4.650	**157**	**
2025					
2026					
2027					
2028					
2029					
2030	5.000	Uninsur.	5.000	**152**	**
2031					
2034					
2040	5.000	Uninsur.	5.150	**129**	**
2041					

*** Priced to the call on 6/1/20**
**** Optional call on 6/1/20**

Legislative and Regulatory Update—PABs

- **PABs are under great assault from the deficit hawks who want to eliminate tax exemption for newly issued private activity bonds.**

- **The Internal Revenue Service has issued new guidance for their private-activity bond volume cap allocations on drawn down bonds.**
  - Smaller issuers who privately place draw-down bonds (usually PABs) with a bank are only obligated to pay interest on the amounts that have been tapped.
  - Under the new IRS guidance, draw-down bonds are considered issued at the first draw of bond proceeds for purposes of obtaining an allocation of PAB cap.

- **Legislation has been introduced in both the House and Senate that would exempt water and sewer bonds from states' private-activity volume caps.**
  - Proponents think that water and sewer bonds exempt from the cap could generate $50 billion in investment and 28,500 new jobs.

- **Sen. John Kerry, D-Mass., unveiled legislation for a national infrastructure bank that could finance up to $10 billion of projects in each of its first two years. Kerry's legislation would also exempt private-activity bonds from the alternative minimum tax in 2011 and 2012.**

Questions

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