

*California Debt and Investment Advisory Commission  
Debt Essentials Seminar*

# Introduction: Recent Trends in the Bond Market

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  - Published “California’s Credit Crisis: Financing Credit Facilities After the Financial Storm” in *Debt Line* in December 2009



# Key Trends and How they are Affecting Issuers

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- Interest Rates
- Credit Trends
- Players
- Regulation
- What's it All Mean to You



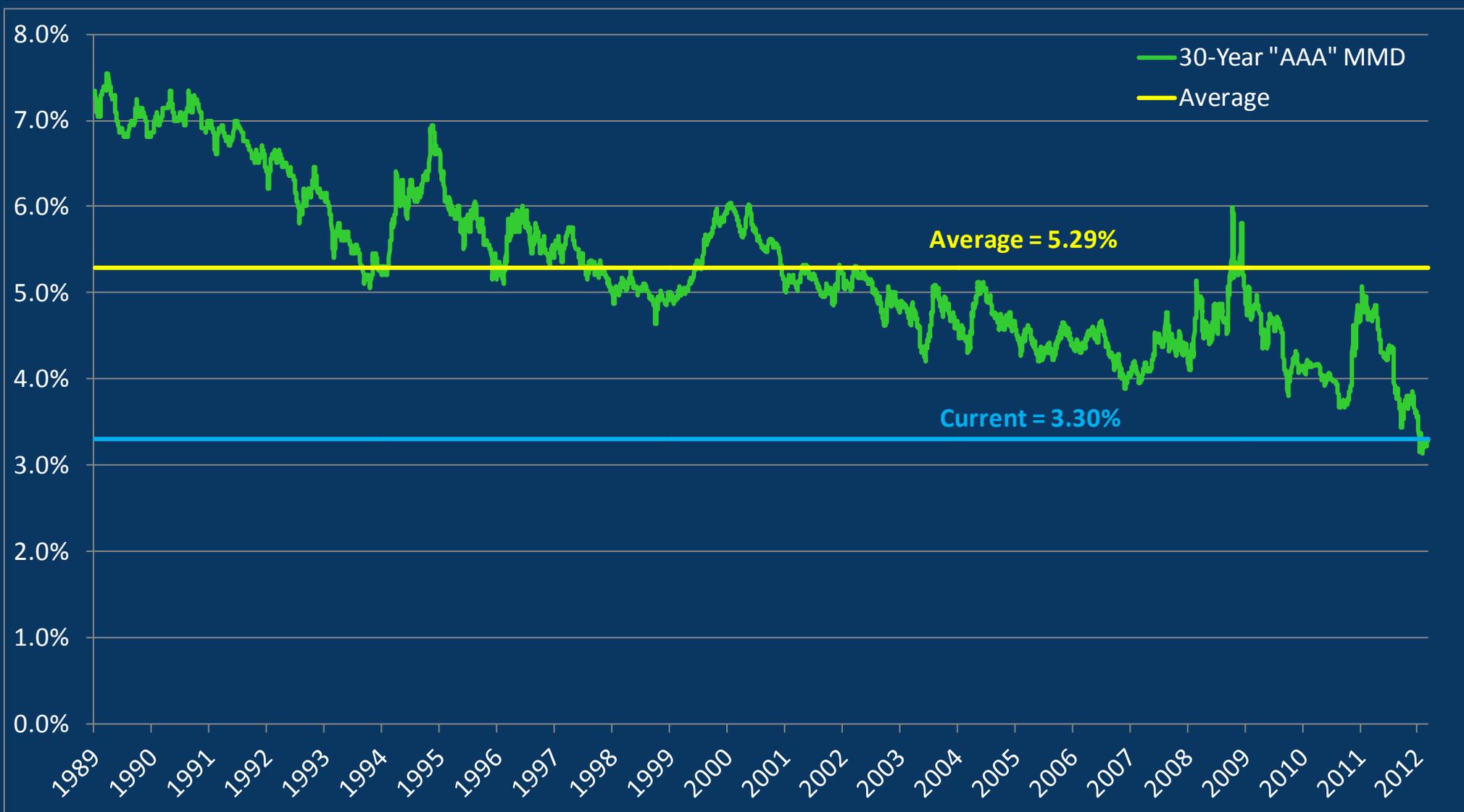
# From "Boring Bonds" to ... 2012

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# Trend 1: Low Rates

## Historical "AAA" MMD

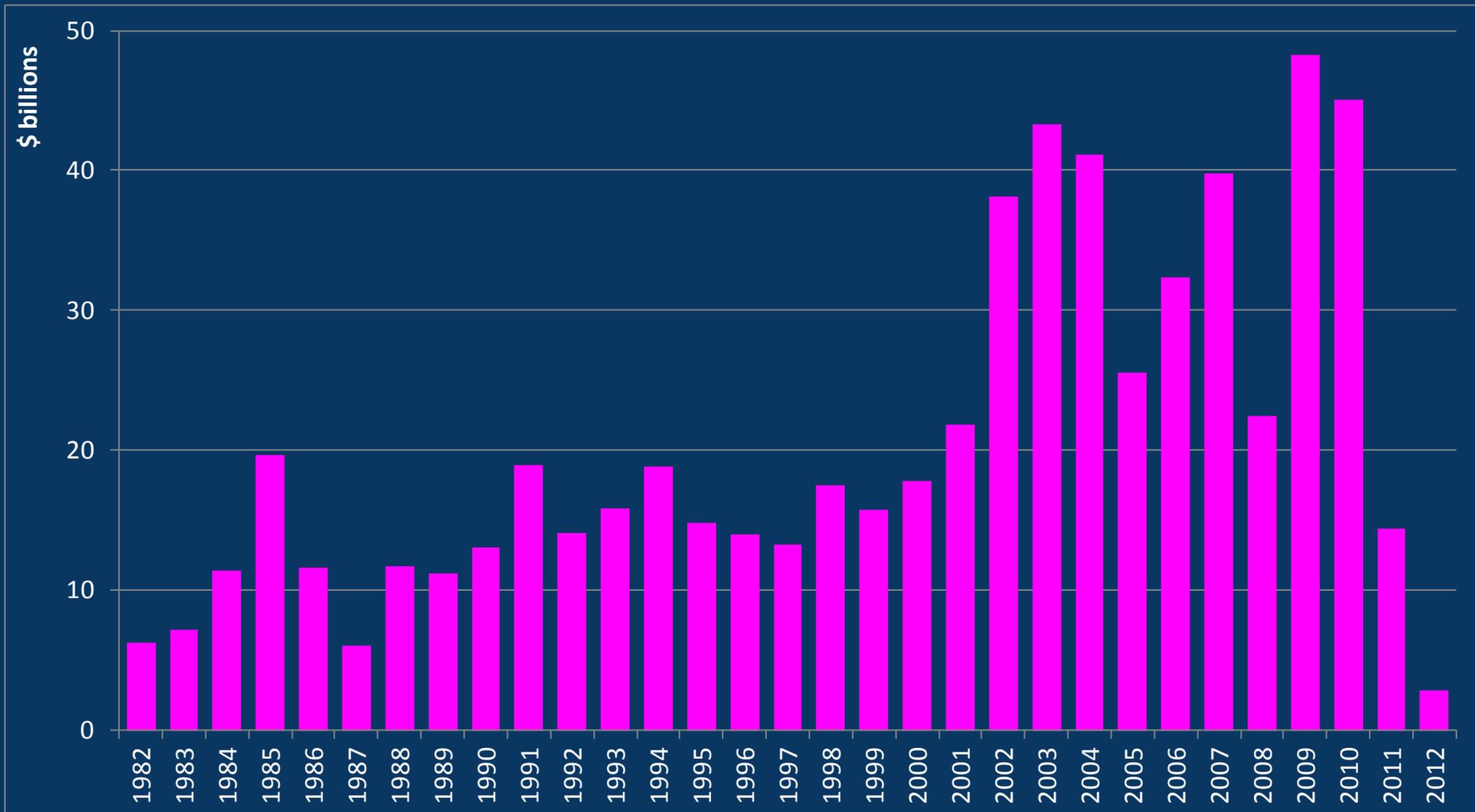


Source: Municipal Market Data. As of March 8, 2012.



# Why: Supply is Down

## Historical New Money Issuance in California

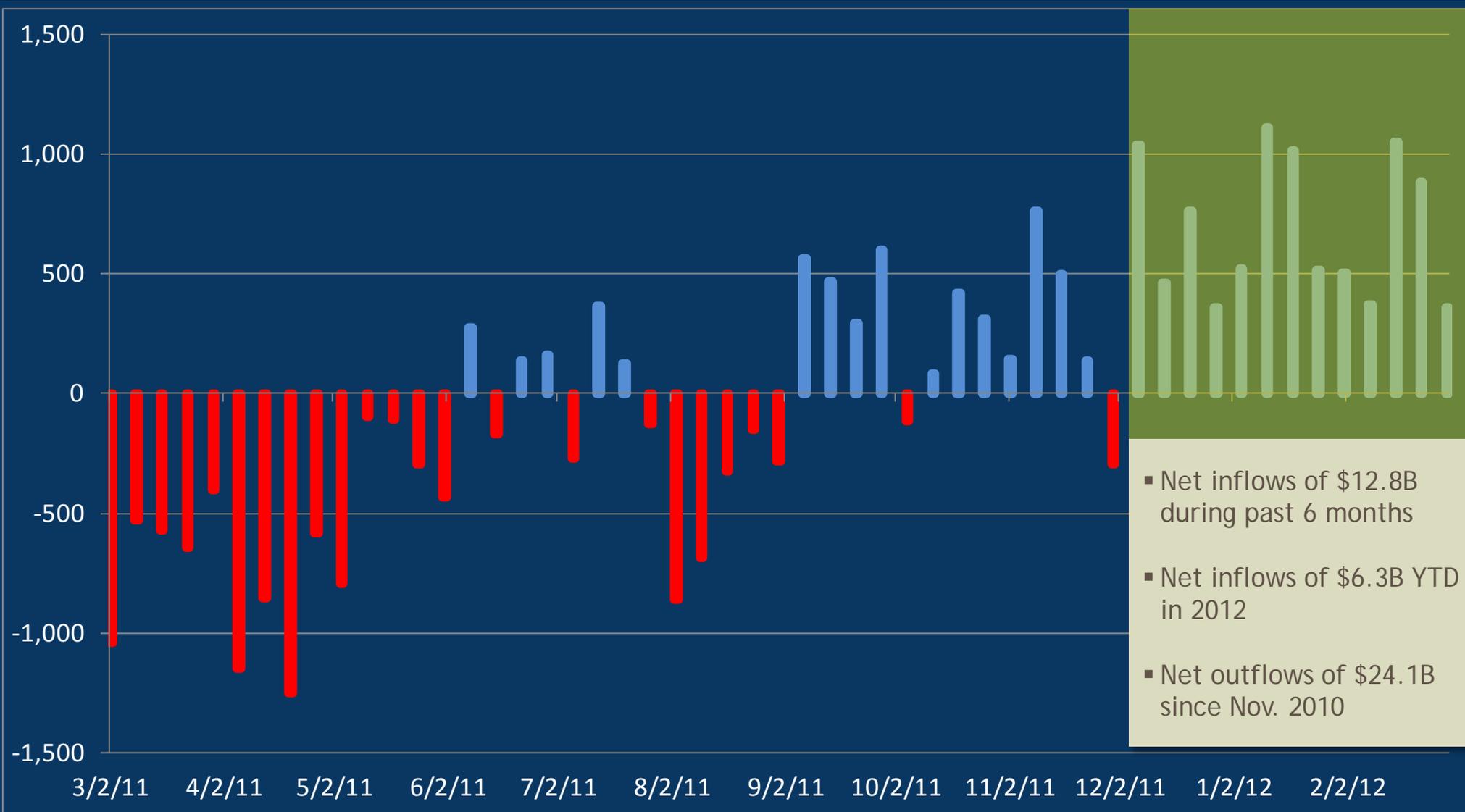


Source: Thomson Reuters SDC Platinum. As of March 8, 2012.



# Why: Demand is Up Again

## Money Market Flows (2011 to Present)

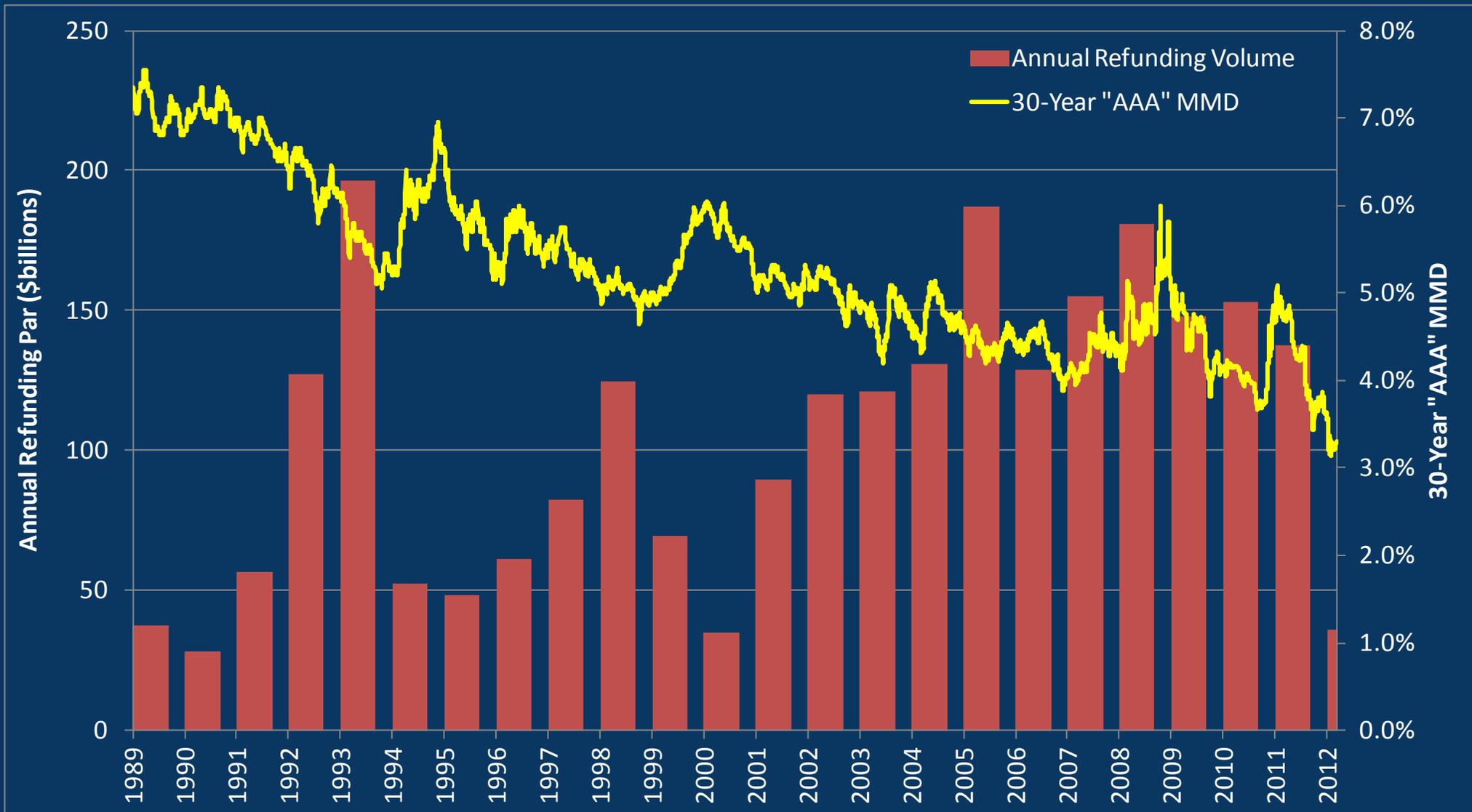


Sources: Thomson Reuters, Lipper FMI. As of March 2, 2012.



# Result: Refunding Opportunities

## Historical Refunding Issuance Volume and 30-Year "AAA" MMD

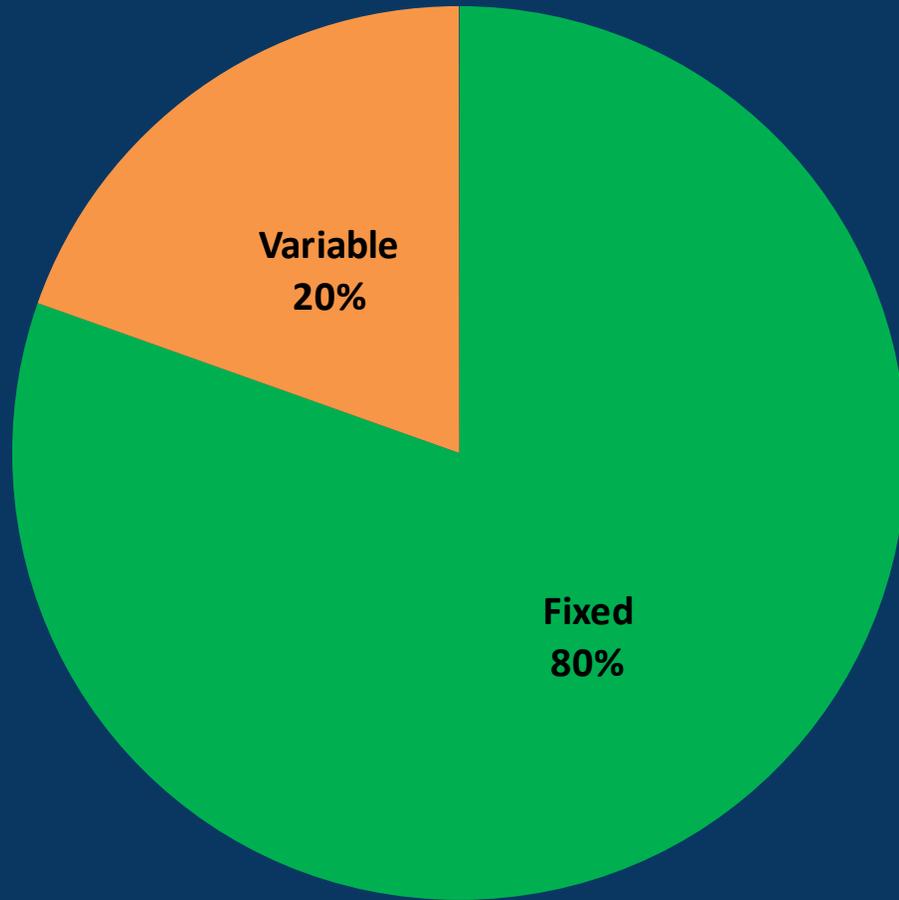


Source: Thomson Reuters SDC Platinum and Municipal Market Data. As of March 8, 2012.

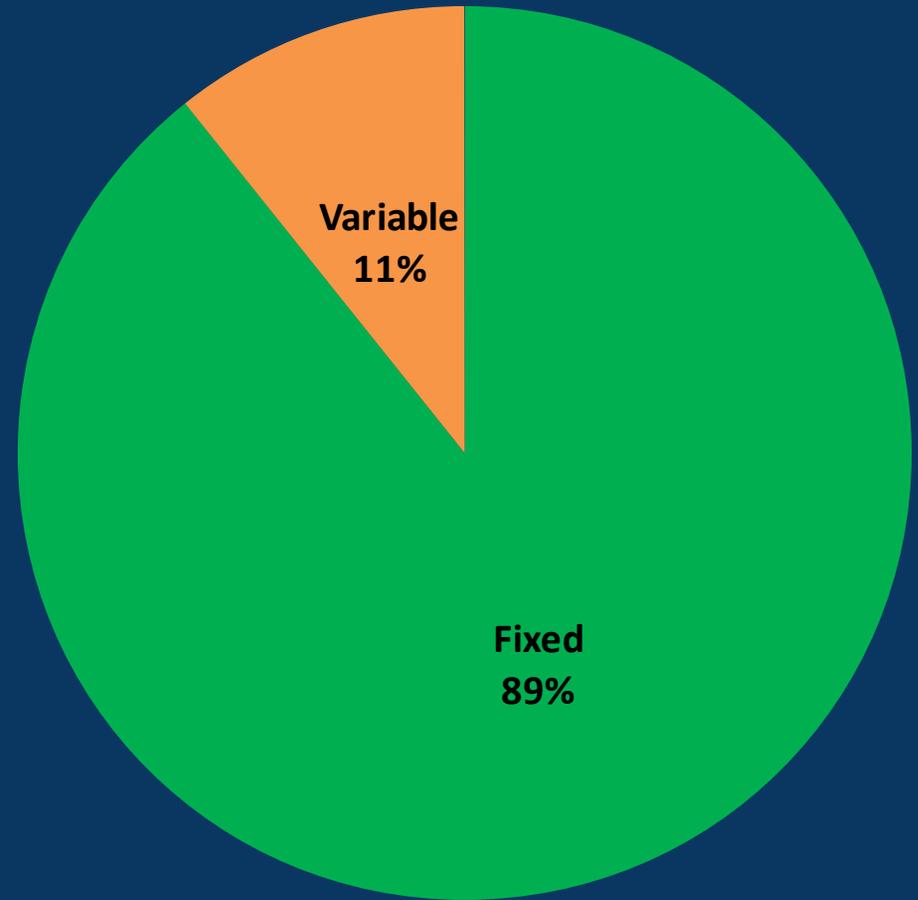


# A Renewed Focus on Refundings

2006 California Issuance



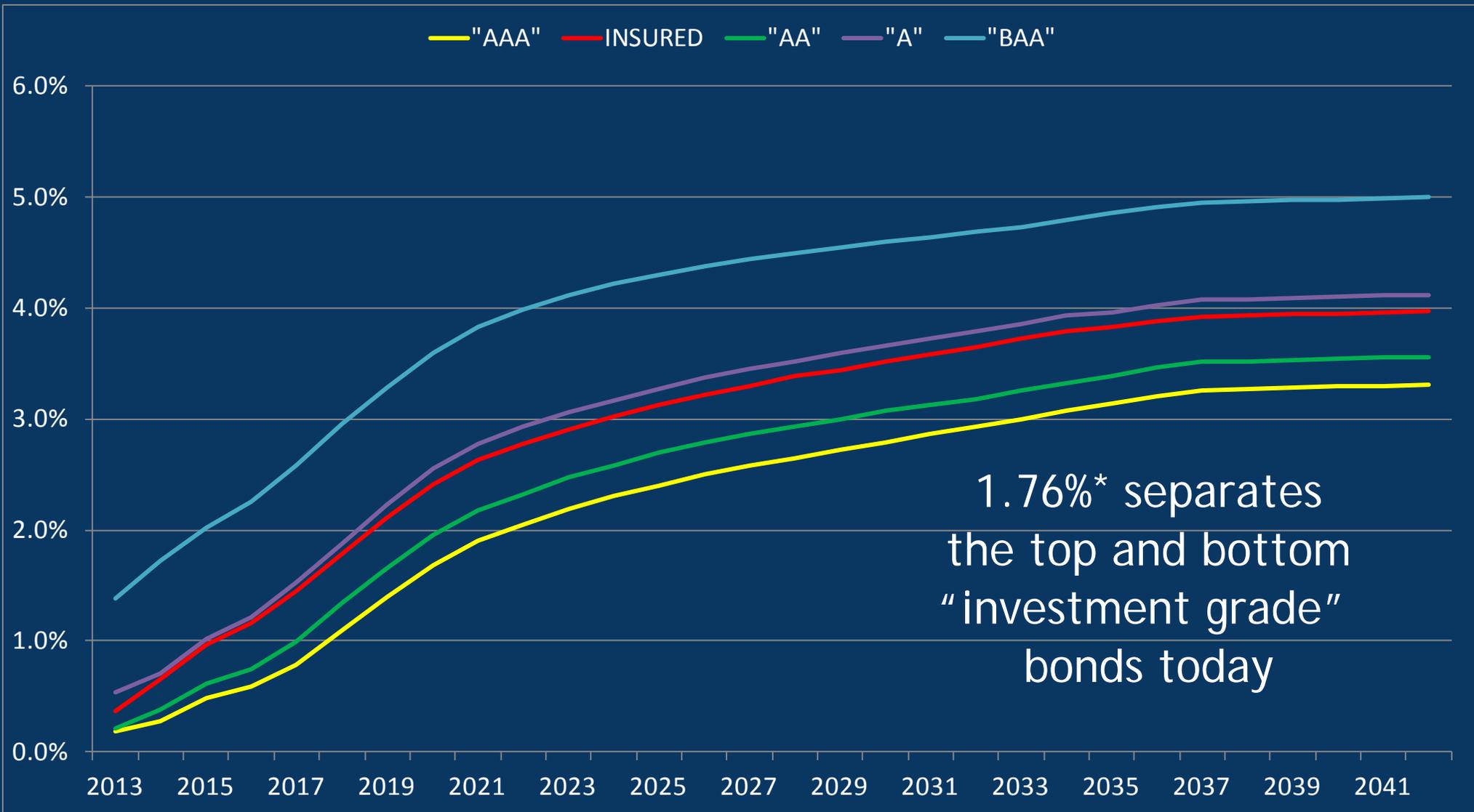
2011 California Issuance



Source: Thomson Reuters SDC Platinum. As of March 8, 2012.

# Trend 2: Credit Spreads Remain Wide for the Weak

## Interest Rates by Credit Ratings Today



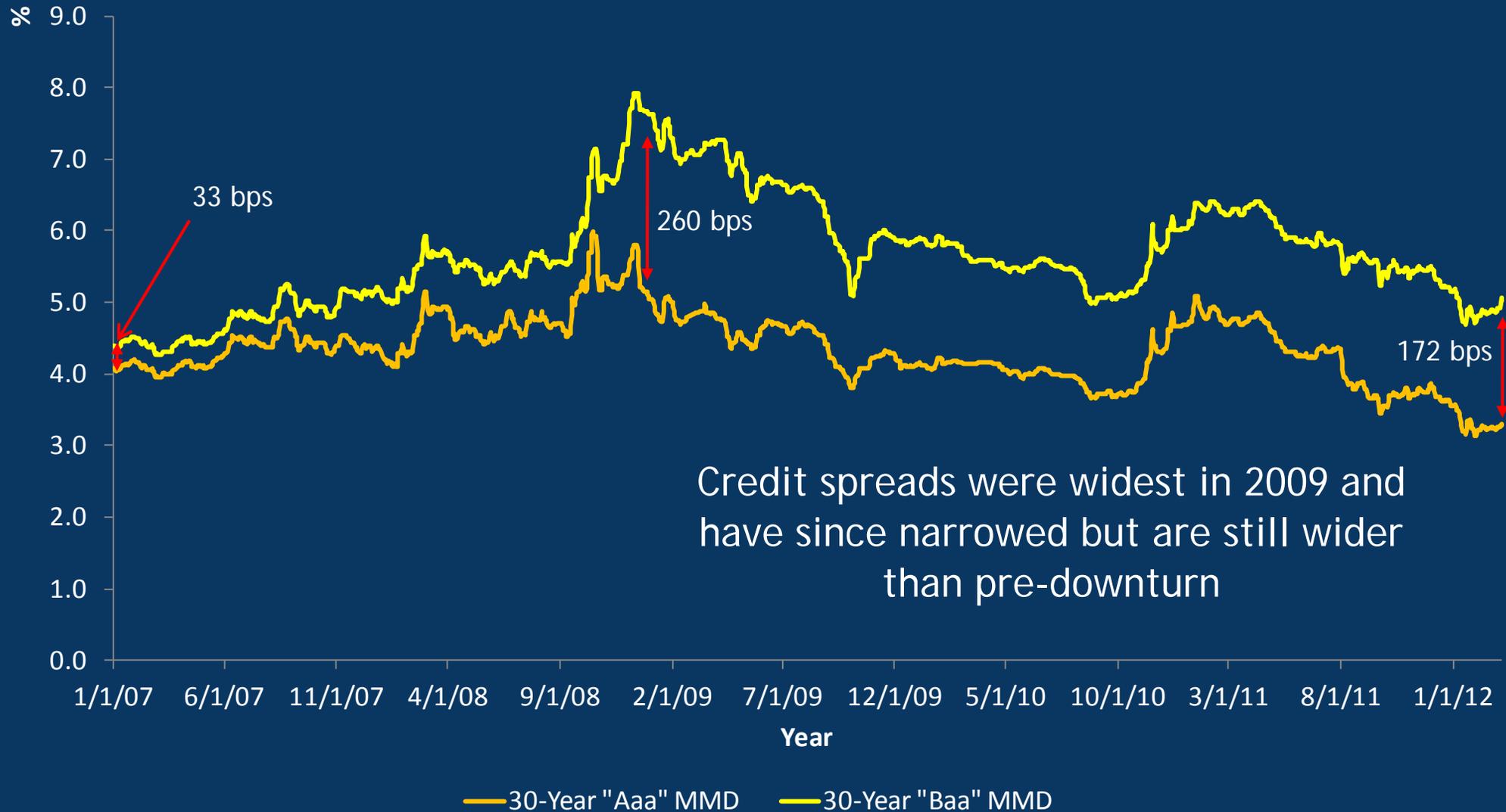
1.76%\* separates the top and bottom "investment grade" bonds today



\* Represents average spread across the 30-year curve.  
Source: Municipal Market Data. As of March 8, 2012.

# Why: Credit Flight Follows Credit Turmoil

## Historical Credit Spreads



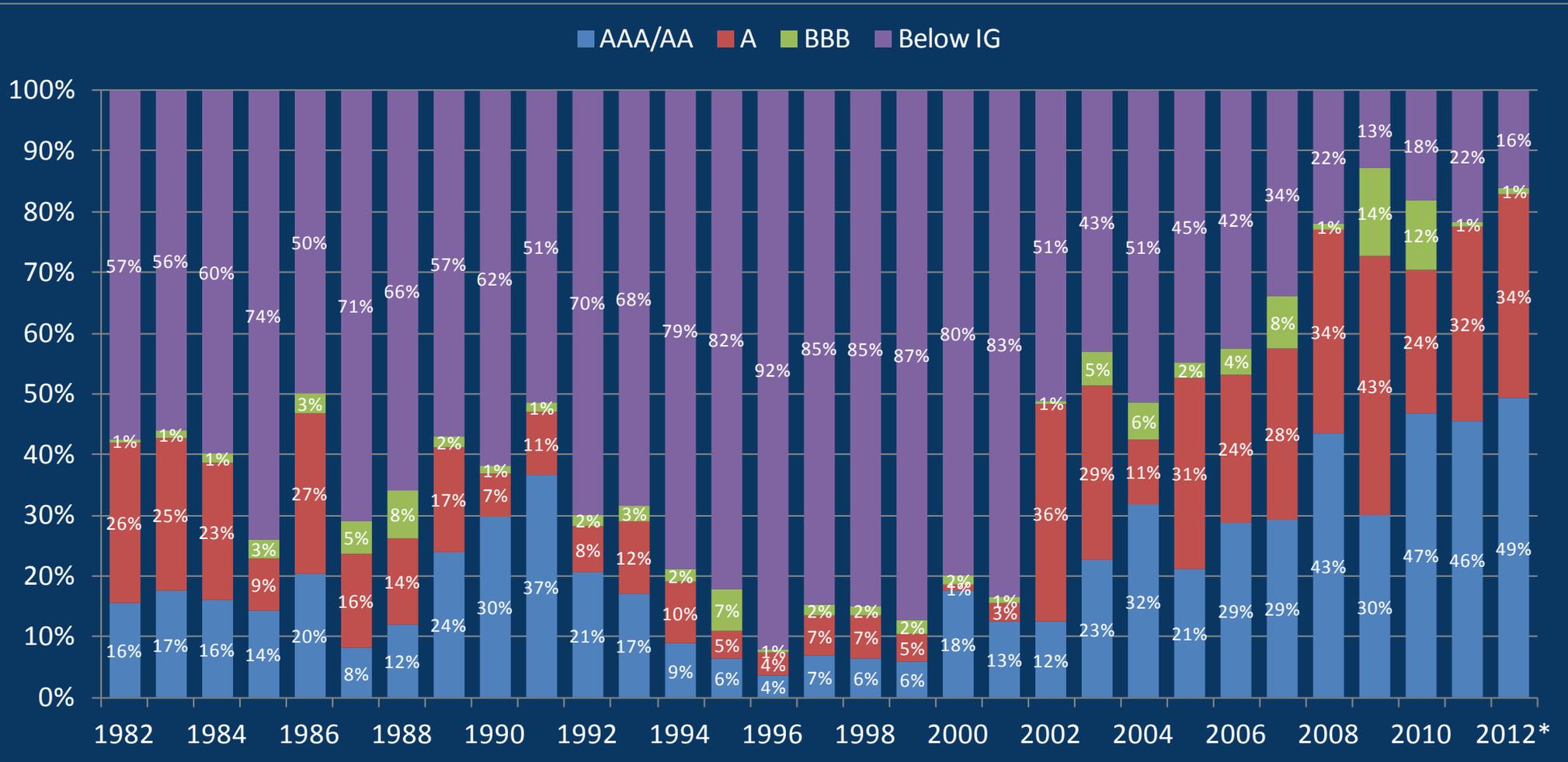
Credit spreads were widest in 2009 and have since narrowed but are still wider than pre-downturn



Source: Municipal Market Data. As of March 8, 2012.

# Result: Strong Credits Have the Best Market Access

## Historical California Issuance by Underlying Credit Rating



\* 2012 year-to-date as of March 8, 2012.

Source: Thomson Reuters SDC Platinum. Ratings based on underlying long-term rating by Moody's. As of March 8, 2012.



# Trend 3: The Disappearance of Bond Insurance

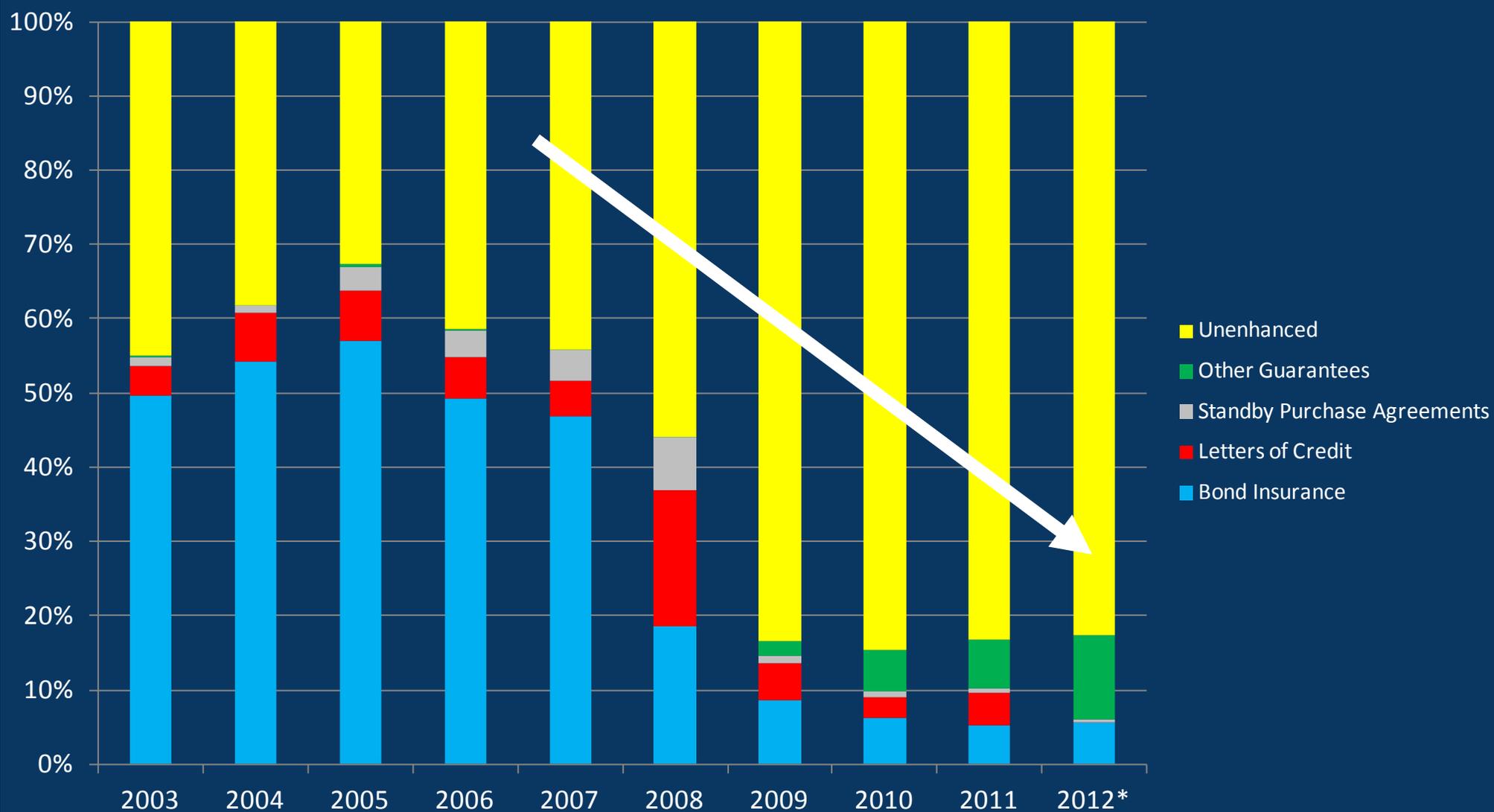
<u>Insurer</u>	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch</u>
	Aa1 Stable	AA+ Negative	Not Rated
	Aa3 Negative Outlook	AA- Stable	Withdrawn
	Withdrawn	Withdrawn	Withdrawn
	Baa2 Negative	BBB Outlook Developing	Withdrawn
	Withdrawn	Withdrawn	Withdrawn
	Withdrawn	Withdrawn	Withdrawn
	Withdrawn	Withdrawn	Withdrawn
	Ca Outlook Developing	Withdrawn	Withdrawn

Source: Bloomberg. As of March 8, 2012.



# Result: More than 80% of Market Unenhanced

## Issuance by Credit Enhancement



Source: Bond Buyer. As of March 6, 2012. 2012 represents year-to-date information.



# Trend 4: An Industry Love-Hate Relationship

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Moody's Investors Service



Standard & Poor's

Fitch Ratings



# Why: What's Been Happening

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- Aaa/AAA rated bonds that were downgraded or defaulted
- “Global Ratings Adjustments”
- Downgrades and Readjustments
- Policy Changes



# Result

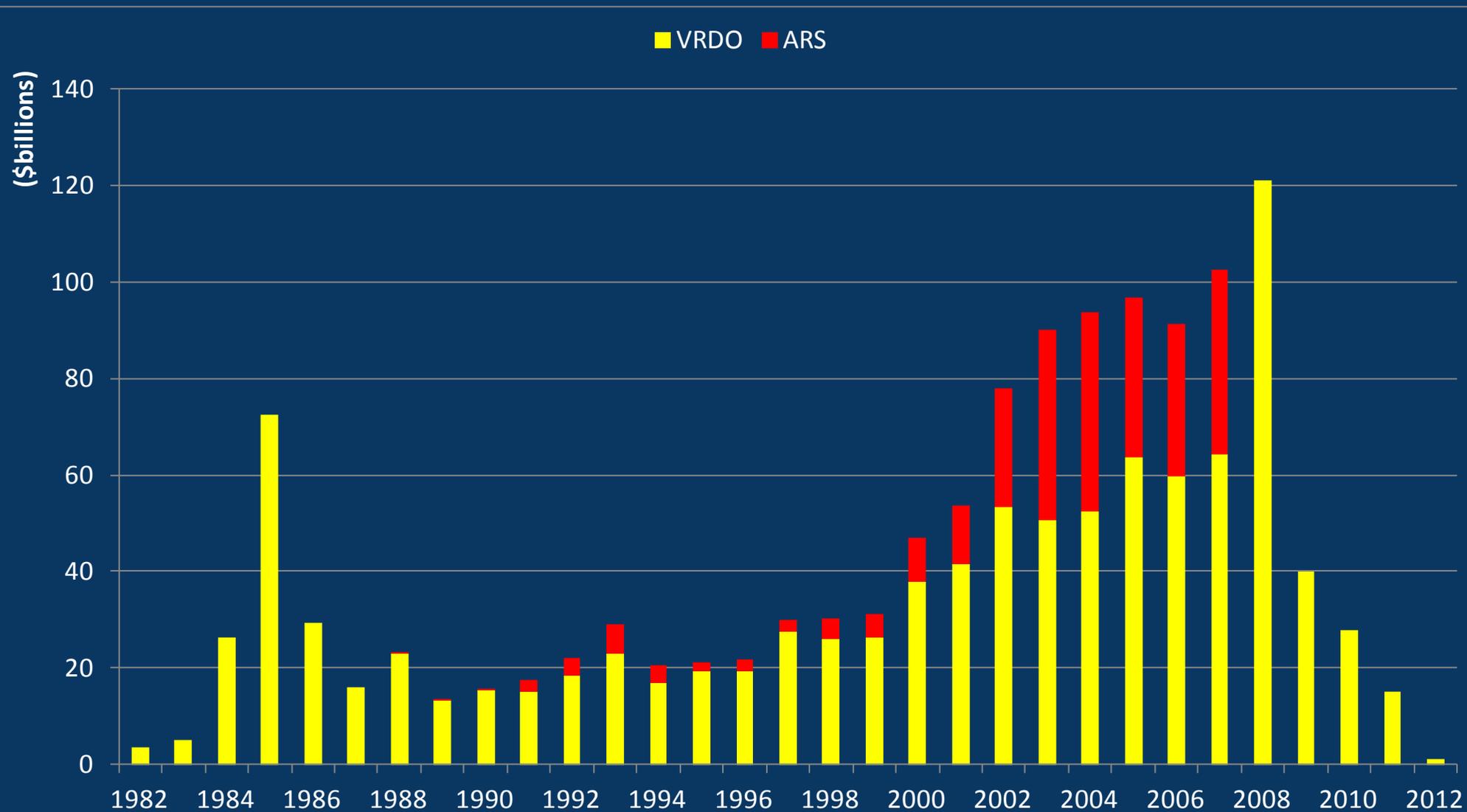
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- Underlying Ratings More in Demand than Ever
- Investors Make Own Rating Judgments
- Need to Reach Investors Directly
- Pressure for Continuing Disclosure / Access



# Trend 6: Dramatic Decline in VRDOs

## Historical Variable Rate Issuance



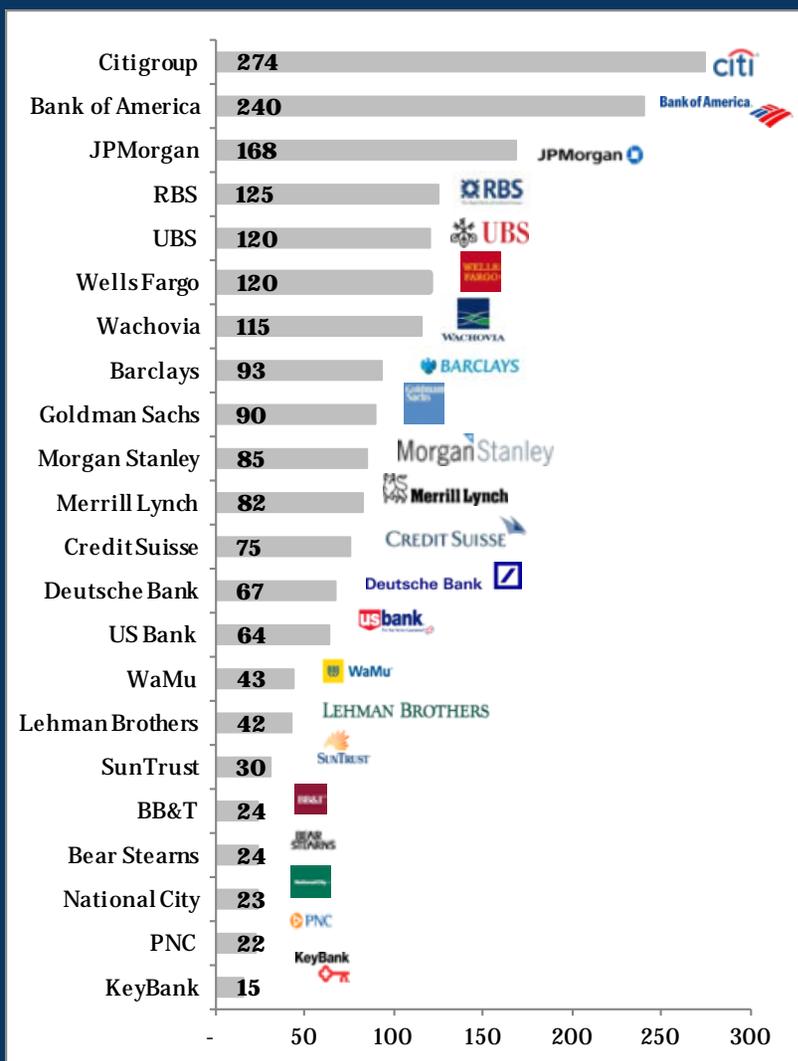
Source: Thomson Reuters SDC Platinum. Consists of ARS, Variable Short, Variable Long and Variable. As of March 8, 2012.



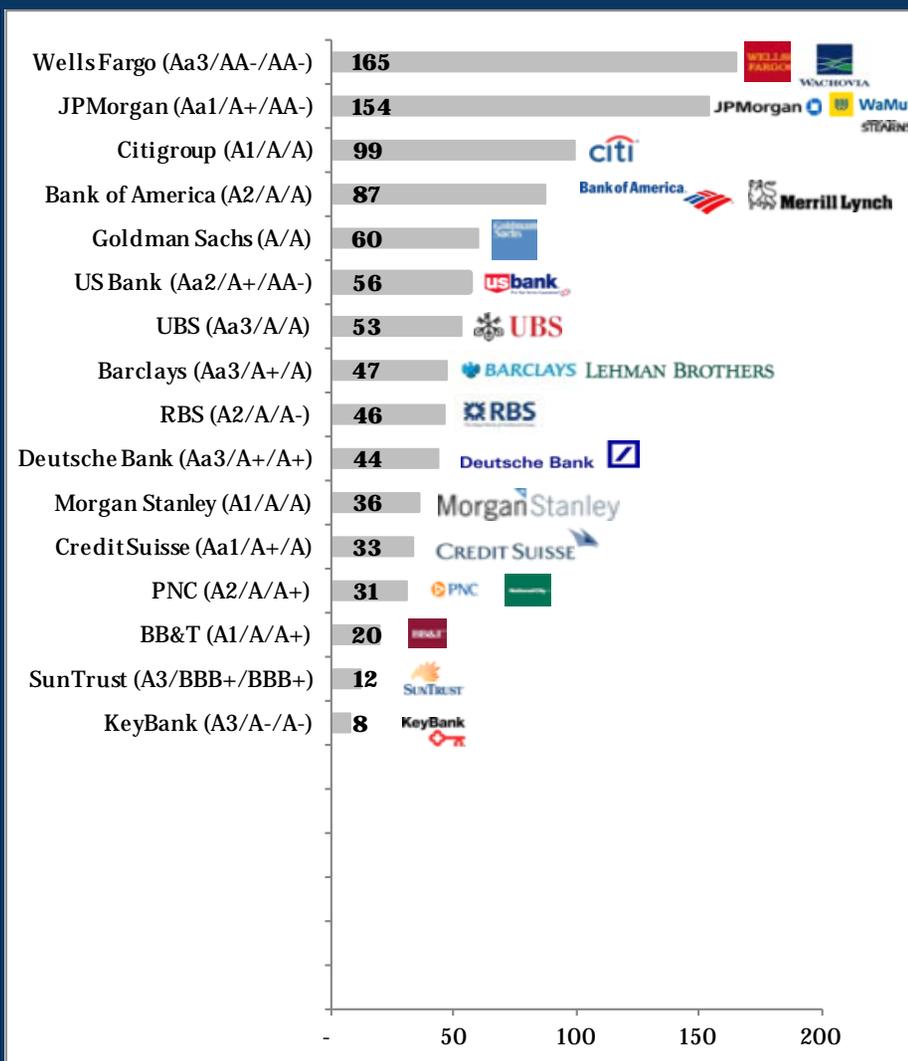
# Why: Changes in the Bank Industry

## Total Market Capitalization

January 1, 2007



March 8, 2012



Source: Bloomberg. Company websites. Market Cap as of March 8, 2012; Ratings as of February 16, 2012.



# Changes in the Letter of Credit Industry

## Top 20 LOC Banks in 1991

Rank	Bank	Principal Amount	Mkt. Share	National Flag
1	Mitsubishi Bank	738.2	7.8	
2	Sumitomo Bank	701.7	7.4	
3	Societe Generale	576.2	6.1	
4	Industrial Bk of Japan Tr Co.	574.9	6.0	
5	Morgan Guaranty	542.6	5.7	
6	Swiss Bank Corporation	516.4	5.4	
7	AMBAC	493.2	5.2	
8	National Westminster Bank PLC	427.0	4.5	
9	FGIC	423.0	4.5	
10	Citibank NA	320.4	3.4	
11	Student Loan Marketing Asoc	313.3	3.3	
12	Union Bank of Switzerland	305.2	3.2	
13	Sumitomo Trust & Banking	299.6	3.2	
14	The Fuji Bank, Limited	287.4	3.0	
15	Bank of Tokyo	253.0	2.7	
16	Credit Suisse	187.6	2.0	
17	Toronto-Dominion Bk & Tr Co.	165.9	1.7	
18	The Sanwa Bank, Limited	164.1	1.7	
19	Barclays Bank PLC	152.1	1.6	
20	The Tokai Bank, Ltd.	134.9	1.4	
<b>Industry Total</b>		<b>9,510.5</b>	<b>100.0</b>	

## Top 20 LOC Banks in 2001

Rank	Bank	Principal Amount	Mkt. Share	National Flag
1	Bank of America NT&SA	1,268.5	9.8	
2	SunTrust Bank	906.3	7.0	
3	US Bank National Association	525.9	4.1	
4	Allied Irish Banks	491.6	3.8	
5	Bank One, NA	486.1	3.8	
6	Wachovia Bank	465.2	3.6	
7	Landesbank Hessen-Thuringen	436.0	3.4	
8	Bayerische Hypo Vereinsbank AG	413.0	3.2	
9	The Chase Manhattan Bank, N.A.	379.0	2.9	
10	Fleet Bank NA	337.0	2.6	
11	Firststar Trust Company	320.9	2.5	
12	The Bank of New York Mellon	310.9	2.4	
13	Bayerische Landesbank	296.4	2.3	
14	First Union Natl Bk of Georgia	233.1	1.8	
15	Barclays Bank PLC	224.6	1.7	
16	PNC Bank NA	208.3	1.6	
17	US Bank	202.2	1.6	
18	HypoVereinsbank Luxembourg SA	200.0	1.5	
19	AmSouth Bank NA	199.0	1.5	
20	Branch Banking & Trust Co	191.1	1.5	
<b>Industry Total</b>		<b>12,946.0</b>	<b>100.0</b>	

## Top 20 LOC Banks in 2011

Rank	Bank	Principal Amount	Mkt. Share	National Flag
1	J P Morgan Chase	4,051.3	21.5	
2	Citibank	3,618.0	19.2	
3	Wells Fargo Bank	1,679.1	8.9	
4	Bank of America	1,085.2	5.8	
5	US Bank	677.3	3.6	
6	Govt Development Bank for PR	669.2	3.5	
7	Royal Bank of Canada	478.9	2.5	
8	KBC Bank	378.6	2.0	
9	PNC Bank NA	328.3	1.7	
10	Bank of Tokyo-Mitsubishi UFJ	265.6	1.4	
11	Mizuho Financial Group	260.7	1.4	
12	Northern Trust Company	234.4	1.2	
13	The Bank of New York Mellon	221.2	1.2	
14	Bank of Nova Scotia	212.0	1.1	
15	Scotiabank Europe	205.4	1.1	
16	Bank of Montreal Trust	150.0	.8	
17	Union Bank	136.6	.7	
18	TD Bank NA	132.8	.7	
19	FHA	127.5	.7	
20	Barclays Bank PLC	124.4	.7	
<b>Industry Total</b>		<b>18,885.4</b>	<b>100.0</b>	

Source: Thomson Financial and company websites; True Economics Rankings. As of January 12, 2012.

# Select Credit Bank Ratings and Trading Relationships

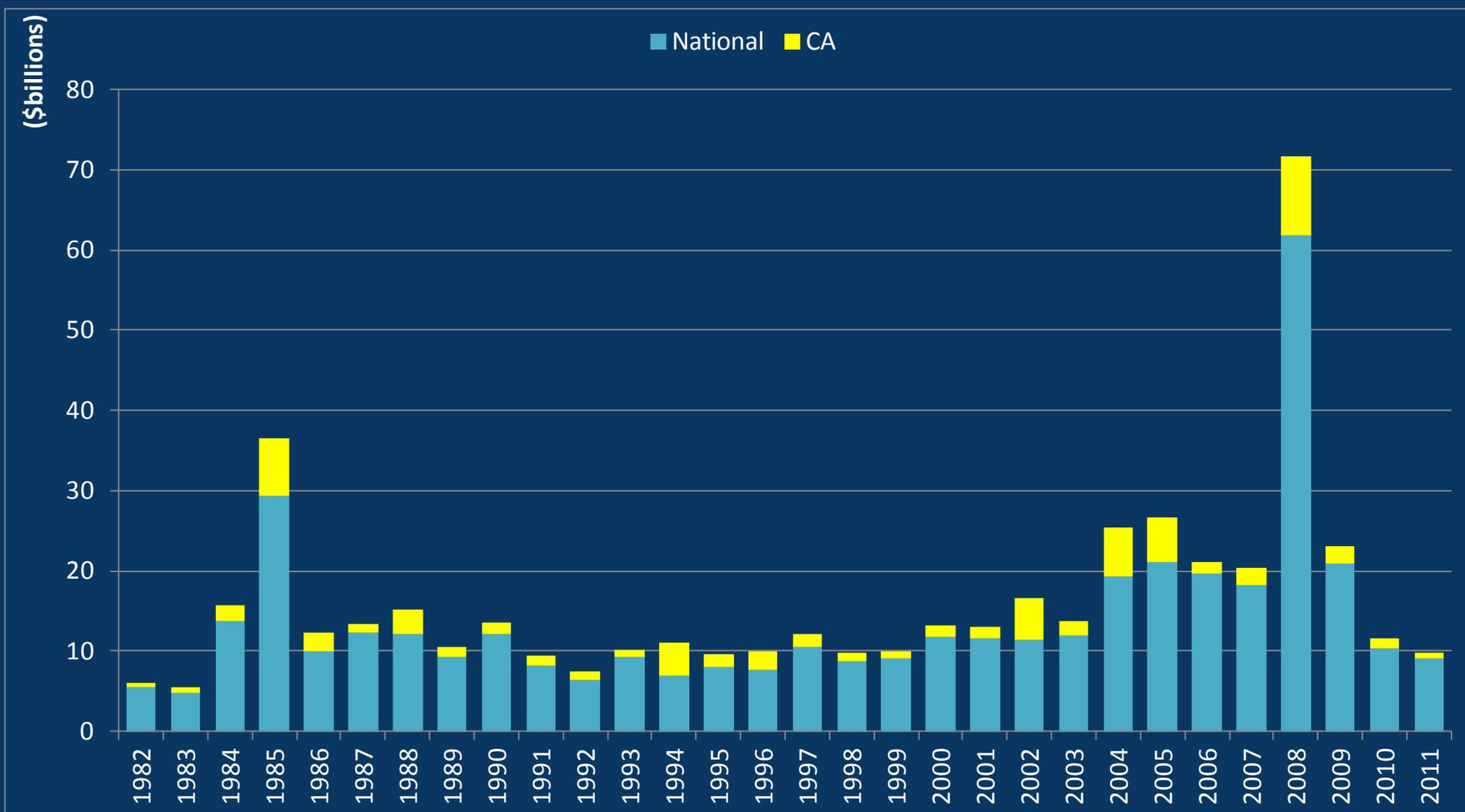
Long-Term Ratings			
Bank	Moody's	S&P	Fitch
Wells Fargo Bank	Aa3	AA-	AA-
J.P. Morgan	Aa1	A+	AA-
U.S. Bank	Aa2	A+	AA-
Northern Trust	Aa3	AA-	AA-
Bank of America	A2	A	A
BB&T	A1	A	A+
Citibank	A1	A	A
PNC Bank	A2	A	A+
Goldman Sachs	-	A	A
Compass	A3	A-	A-
Keybank	A3	A-	A-
Morgan Stanley	A1	A	A
Fifth Third	A3	BBB+	A-
SunTrust	A3	BBB+	BBB+
Regions	Ba2	BBB-	BBB-

Source: Bloomberg as of February 16, 2012.



# Changes in the Letter of Credit Volume

## Historical LOC Issuance



Source: Thomson Reuters SDC Platinum. As of March 8, 2012.



# General Trends in Credit Enhancement

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- Banks retaining capacity for existing clients
- Pricing remains competitive
- Greater attention to documentation
- Top three banks accounted for 50% of volume<sup>(1)</sup>
- Number of banks providing enhancement has declined since 2008, with little activity from foreign banks



(1) Thomson Financial; True Economics Rankings. As of January 12, 2012.

# But the Stats are misleading...

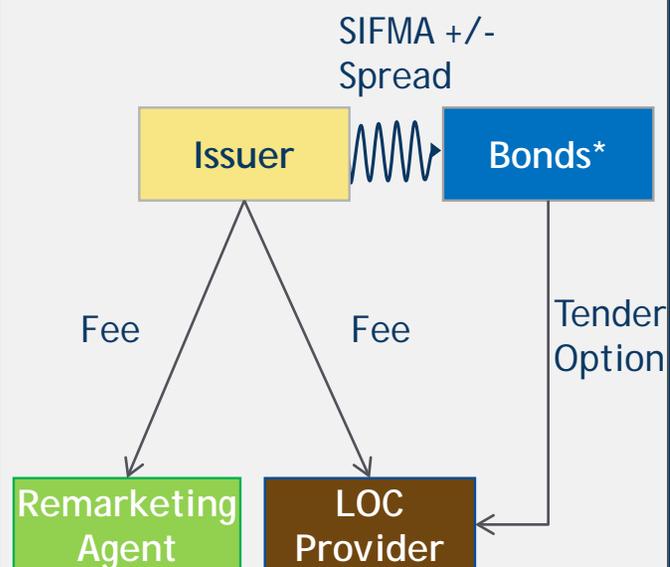
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- While the decline in variable rate and LOC issuance is genuine, it is also vastly overstated
- Significant movement to on-balance sheet enhancement alternatives: Direct Purchase by Banks
- Different banks are doing the product differently and the generic term really describes multiple products
- Volume significant
  - Some banks buying as securities, some as loans
  - Some show up in market data, much does not



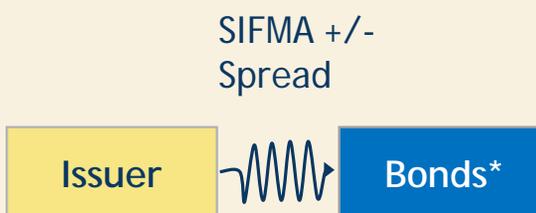
# Three Basic Models

## VRDO Structure



\* Bonds purchased by Investors

## Index Floater Structure



\* Bonds purchased by Investors

## Bank Direct Purchase Structure



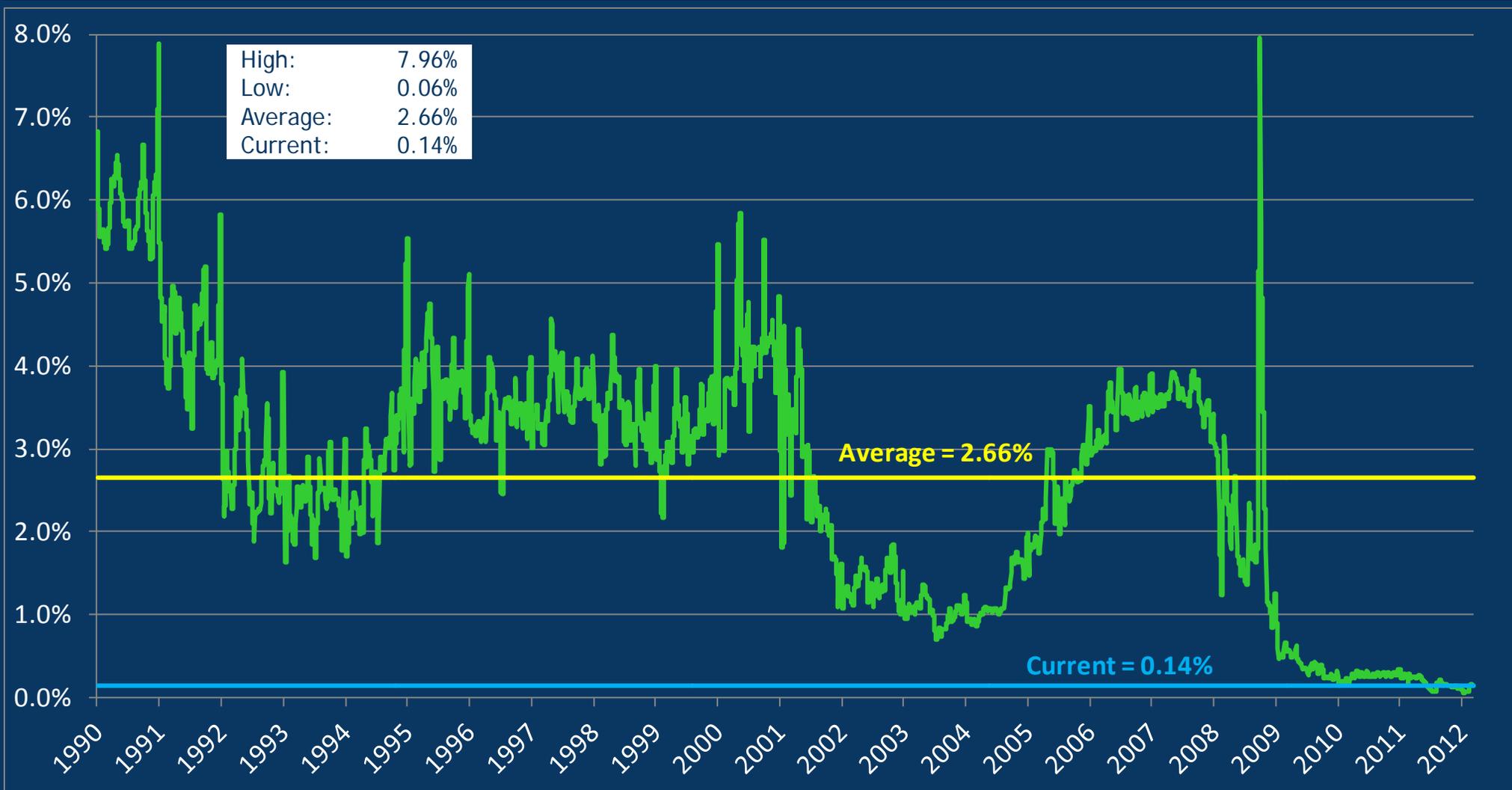
\*\* Bonds purchased by Bank

‡ Under certain credit events, the Bank may accelerate repayment of the securities



# Trend 7: Low Variable rates

## Historical SIFMA

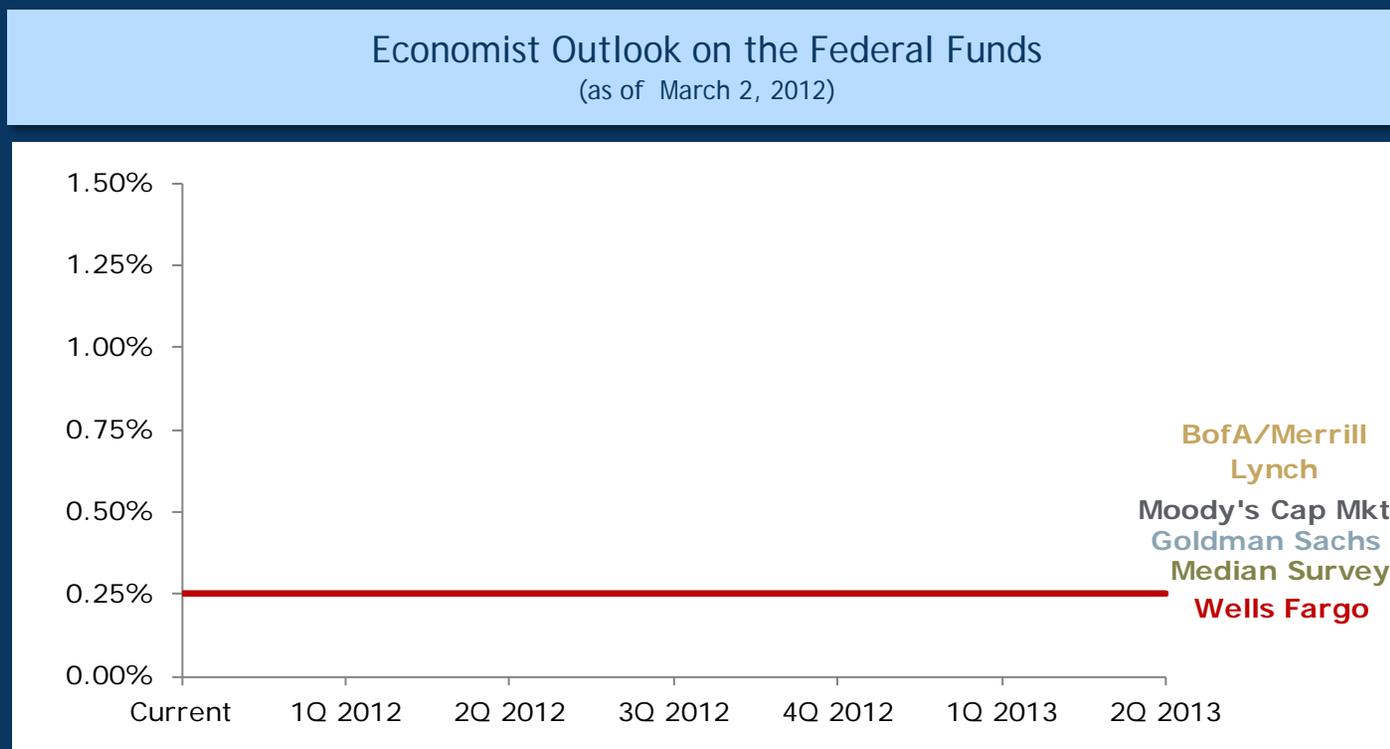


### ■ Period of extraordinarily low rates



Source: Bloomberg. As of March 8, 2012. Average data based on data from 1/1/1990 through 3/7/2012. Current as of 3/7/2012.

# Why: Rare 'Moment of Clarity'

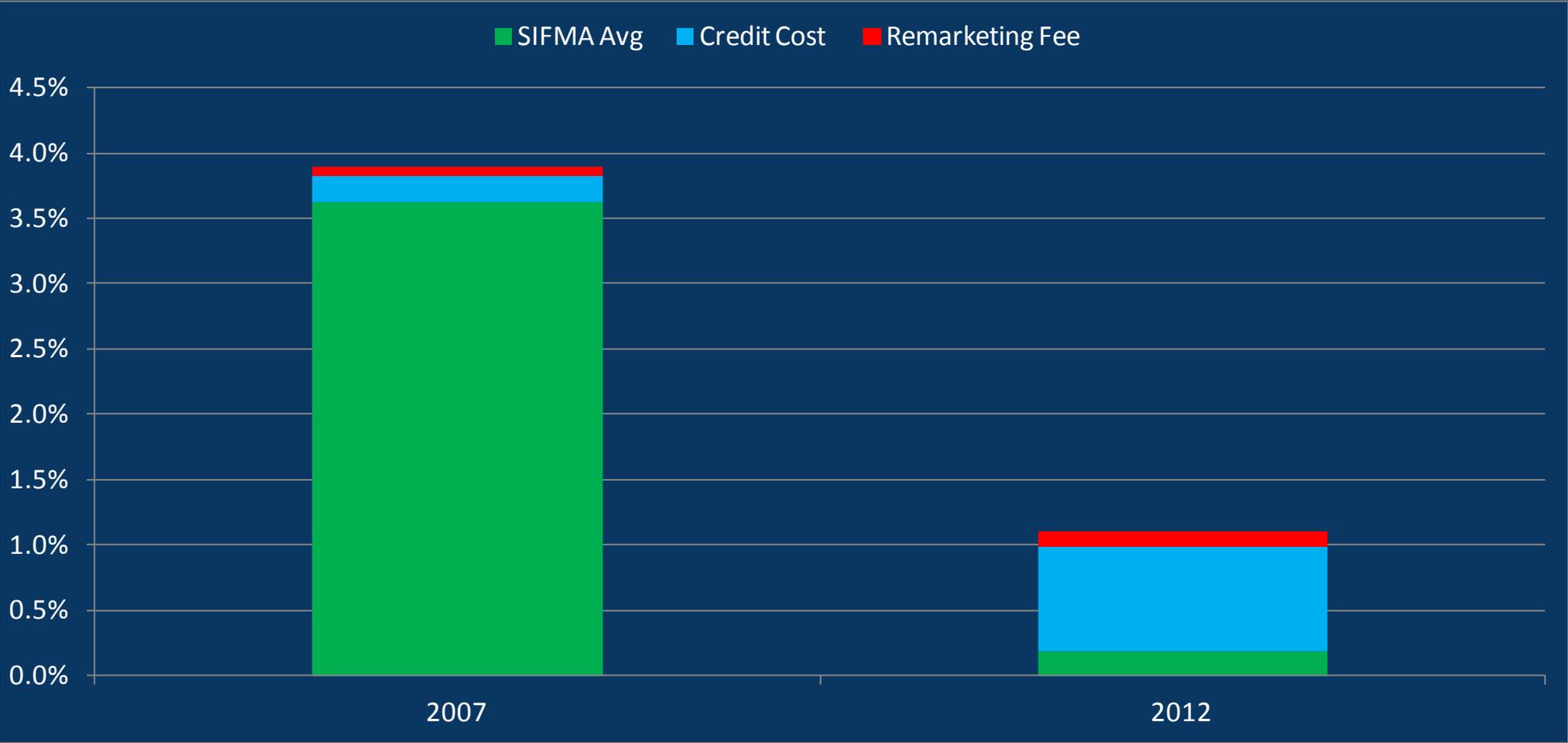


- Unique clarity from the Fed's recent outlook for rates
- Short-term rates are expected to remain low through 2013



# Result: Changing Borrowing Dynamics

Generic Variable Rate Cost Comparison (2007 vs. 2012)

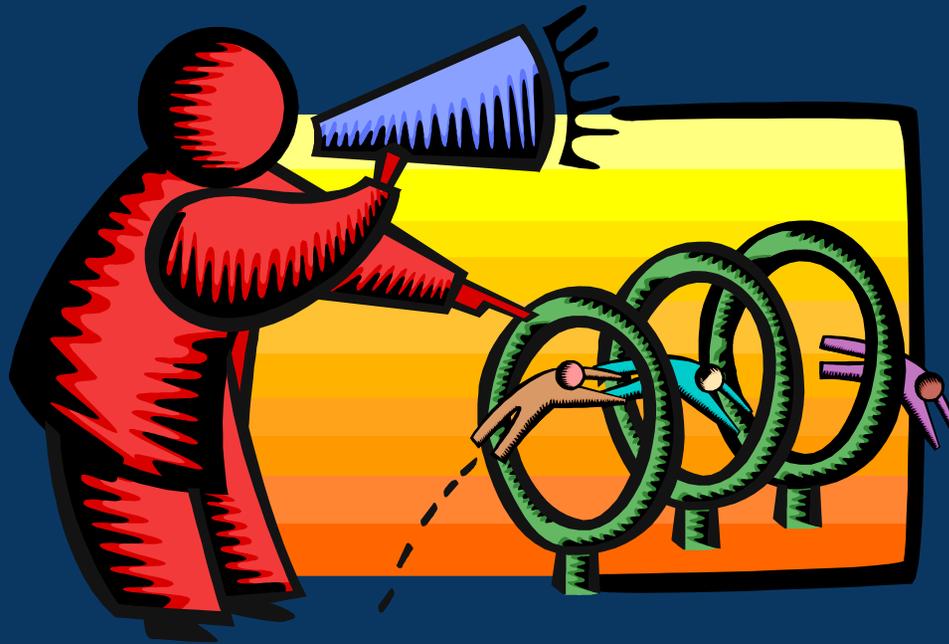


Assumptions: 2007 SIFMA average of 3.62%; 2012 SIFMA Average of 0.18%; 2007 Credit Costs of 0.20%; 2012 Credit Costs of 0.80%; 2007 Remarketing Fee of 0.08%; 2012 Remarketing Fee of 0.12%.



# Trend 8: Regulatory Changes

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- Municipal Securities Rulemaking Board
- Securities Exchange Commission
- Internal Revenue Service
- Disclosure and Continuing Disclosure



# Conclusion: Where to Next?

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2037

- The Future of Tax Exemption vs. Tax Credits
- National Infrastructure Bonds?
- Basel III and Role of Banks?
- Rates and Economic Recovery?

2012



# Questions and Follow up

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