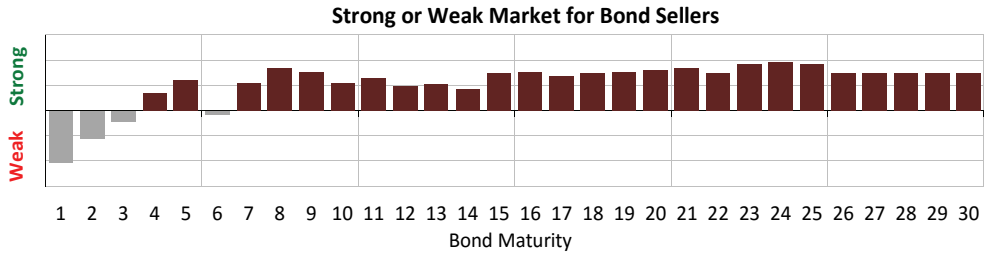
MMA Independent and Data Driven

FirstSouthwest
A Division of Hilltop Securities.

# MUNICIPAL MARKET JOURNAL




| MMA 5% AAA Benchmark | | | |
|---|---|---|---|
| | *4/8/2016* | *4/1/2016* | *Change* |
| ***2-yr*** | 0.58% | 0.60% | -2 |
| ***5-yr*** | 1.03% | 1.11% | -8 |
| ***10-yr*** | 1.68% | 1.79% | -11 |
| ***30-yr*** | 2.66% | 2.78% | -12 |

*Municipal prices remained amplified in the first week of April, continuing the positive momentum established in mid-March. The positive forces have presented an attractive pricing context for issuers in nearly every maturity on the yield curve.*

## MARKET UPDATE

*Since 2008, the municipal market has often displayed gains > 1.0% in April. MTD the prices have already gained > 1.0%.*

## HIGHLIGHTS

- Municipal yields ended last week at their lowest point in over three years, and are once again only a few basis points away from their modern low attained in December 2012.
- This performance has not only reinforced: 1) positive seasonal expectations for April, but also: 2) the market's durability when fund inflows are consistently positive; and 3) a pivot in investor expectations away from materially higher bond yields by year-end.
- Strengths include not only a $15B (12.0%) decline in YTD issuance versus last year, but also continued strength in weekly mutual fund inflows (averaging $1.2B/week since the beginning of March).
- This has dropped net unfunded supply (primary issuance minus fund inflows) by 25% in recent weeks, leaving only $6B/week left over for other investors—a favorable imbalance that has contributed to a constructive and competitive pricing context for issuers.
- The imbalance has helped to drive strong incremental performance from new issue purchases, in particular for already well known credits. And, the strength has finally begun to bleed into secondary market performance more fully last week, in particular in longer maturities were fund demand has been strongest.
- An effective index of **MMA** maturities 21yrs and longer is up by 4.0% YTD, versus 3.5% for intermediate maturities and 3.1% for the curve as a whole. Similarly, the **MMA**-MMD 30yr maturity spread—a good proxy for strength on the offered side of the market—has rallied by 10 bps lower since March 7. Hence the strong positive pricing context in longer maturities.
- As a result, the municipal 2 to 30-year yield curve slope flattened by 10 bps last week alone. Relative municipal flattening vis-à-vis U.S. Treasuries will eventually induce incremental supply through advance refundings—a trend that has been in force in 2016.
- Issuers have also benefitted from less secondary institutional selling over the past 3 weeks; and dealers have effectively placed new issues that have priced. Nonetheless, underwriters may soon become increasingly wary as the rally becomes perceived as nearing an end.

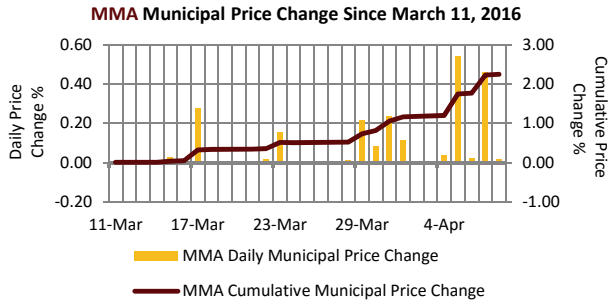



*Figure 1: **MMA**'s municipal price index has rallied every day but one since March 11. The cumulative gain has been nearly 2.5%.*

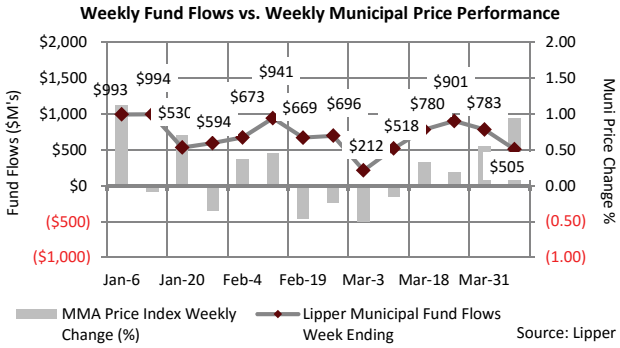



*Figure 2: Municipal bond funds have tapered in recent weeks as yields have fallen, and equities good performance has been an investor distraction. Still, municipal price performance was the strongest over a 5-day period since the start of the year, up nearly 1.0%.*

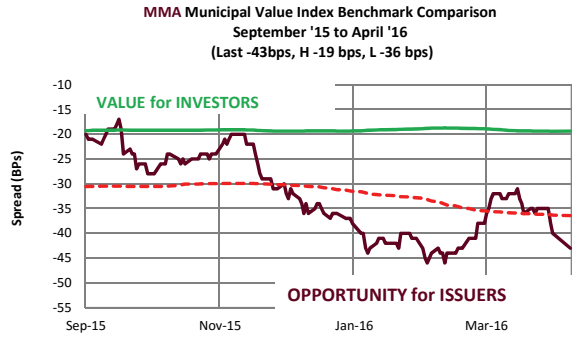



*Figure 3: Issuers have benefitted in 2016, relative to investors. **MMA**'s Value Index contrast last Fall when the 10-year yield was 67 bps higher.*

## LINKED CREDITS AND USE OF PROCEEDS

**GOVERNMENT LINKAGES: THE TIES THAT BIND:** The financial, economic, governance and/or operating environment linkages between separate governmental entities was in focus in a recent Moody's special comment. The report's premise that binding factors between governments must be considered across the rating spectrum is one that we find is often under-appreciated in credit assessments. Market participants should consider that the rating agency's attention to these elements has likely been elevated. **MMA** expects that growing rating divergences among credits with identified linkages will be keenly monitored, resulting in tighter rating relationships. Moody's report highlights several examples of the impact of governmental linkages, including the shared operating environment of MI school districts. In MI, school districts have been challenged by the state's policy decisions related to public, charter and private schools as well as rising pension costs associated with the state's pension plan. As a result, Moody's downgraded 23.0% of the districts it rates in 2015. **MMA** discussed its views regarding the financial and political linkages of PA with its school districts, which were highlighted during the commonwealth's budget impasse. We posited that very highly rated school districts may be impacted should PA's credit quality and/or political situation weaken further.

**USE OF PROCEEDS GETS ATTENTION IN CALIFORNIA:** In February, CA Senator Hertzberg introduced legislation (SB 1029) designed to improve transparency and issuer accountability for how bond proceeds are spent. The bill is on CA Treasurer Chiang's "must pass" list and as such is one of his key legislative priorities. At present there are no standardized or broadly accepted best practices for ensuring that bond proceeds are properly disbursed. The lack of internal controls for distributing bond funds is of heightened concern in the municipal market given that the use of proceeds can be opaque in offering documents. The increased transparency outlined by the proposed legislation would provide taxpayers, investors and regulators with greater confidence that borrowed funds are being used for their intended purpose and elevate issuer awareness of its responsibilities to lenders and those providing the revenues to service the debt. **MMA** expects that greater ongoing issuer involvement in the management of the bond funds would likely translate into greater attentiveness to other bond disclosure requirements, such as those required by continuing disclosure agreements. This would be an overall positive for the municipal bond market and a critical step towards ensuring taxpayers and regulators that CA issuers are good stewards of taxpayer monies and the tax-exemption, respectively.

## IMPACTFUL BOND DEALS AND ASSOCIATED TRADING

***Below** are **four** new primary deals that have impacted the market recently with associated secondary trading dynamics:*

### LA DWAP

4/7: **Wells Fargo Securities** priced $628M water system revenue bonds for the **Los Angeles Department of Water and Power, CA**; Aa2/AA+/AA; callable at par in 1/1/2026:

**Pricing Notes**: The deal was upsized by nearly $80M following retail orders; and levels were bumped as much as 11 bps during re-pricing.

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2021 | 4.00 | 1.00 | -8 |
| 2026 | 5.00 | 1.67 | -7 |
| 2046 | 5.00 | 2.61 | -11 |

**Secondary Trading:** Secondary market activity has been limited after new issue tickets printed on Friday.

### Univ. of CA

4/7: **Wells Fargo Securities** priced $542M general revenue bonds for the **Regents of the University of California**; Aa2/AA/AA; the first series is $410M bonds, callable at par in 5/15/2026:

**Pricing Notes:** Bonds met strong demand and levels were bumped as much as 10 bps with the largest adjustments out long.

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2021 | 3.00 | 1.04 | -4 |
| 2026 | 5.00 | 1.67 | -7 |
| 2046 | 5.00 | 2.64 | -8 |

**Secondary Trading:** As of Monday, yields remained little changed from original levels as the long bond traded at 2.64%.

### Tarrant Co. CEFFC

4/6: **Citigroup Global Markets Inc.** priced $377M Baylor Scott & White Health revenue bonds for the **Tarrant Co. Cultural Education Facilities Finance Corporation**; Aa3/AA-/NR; callable in 5/15/2026:

**Pricing Notes:** This deal met solid demand and levels were bumped 5 to 10 bps across the curve during afternoon re-pricing.

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2021 | 3.00 | 1.33 | +25 |
| 2026 | 5.00 | 2.13 | +39 |
| 2045 | 5.00 | 3.00 | +29 |

**Secondary Trading:** Bonds broke into the secondary at lower yields; on Monday, 5s of 2045 traded 9 bps stronger than originals.

### FL DoT

4/5: The **Florida Department of Transportation** sold $165M right of way general obligation bonds to **Morgan Stanley & Co.**; Aa1/AAA/AAA; callable at par in 7/1/2026:

**Pricing Notes:** Morgan Stanley was high bid on the bonds and longer dated maturities were offered with sub-5% coupons.

| Maturity | Coupon | Yield | +/- AAA 5% |
|---|---|---|---|
| 2021 | 5.00 | 1.11 | 0 |
| 2026 | 5.00 | 1.76 | -3 |
| 2037 | 3.00 | 3.10 | +51 |

**Secondary Trading:** On Thursday, 5s of 2027 traded at 1.80% vs. an orig. yield of 1.83%; on Monday, yields dropped an additional 3 bps.