ICCCFO SPRING CONFERENCE
The New Federal Tax Law – Its Impact and Debt Strategies Going Forward

TAMMIE BECKWITH SCHALLMO
SENIOR VICE PRESIDENT/MANAGING DIRECTOR

STEPHEN ADAMS
MANAGING DIRECTOR

PMA SECURITIES, INC.

April 18, 2018

VARIABLES THAT IMPACT THE MUNICIPAL BOND MARKET

FED Reserve Policy
Fed Funds Rate

Global Political Events
Centered around
Washington, D.C.

Inflation Expectations

Health of National, State
and Local Economies

State of Illinois Political
Challenges

Bank Qualification

Municipal Bond
Supply and
Demand

Europe

Chicago's Fiscal
Challenges – Pension
Issues

Municipal
Bankruptcies
(e.g. Detroit,
Puerto Rico)

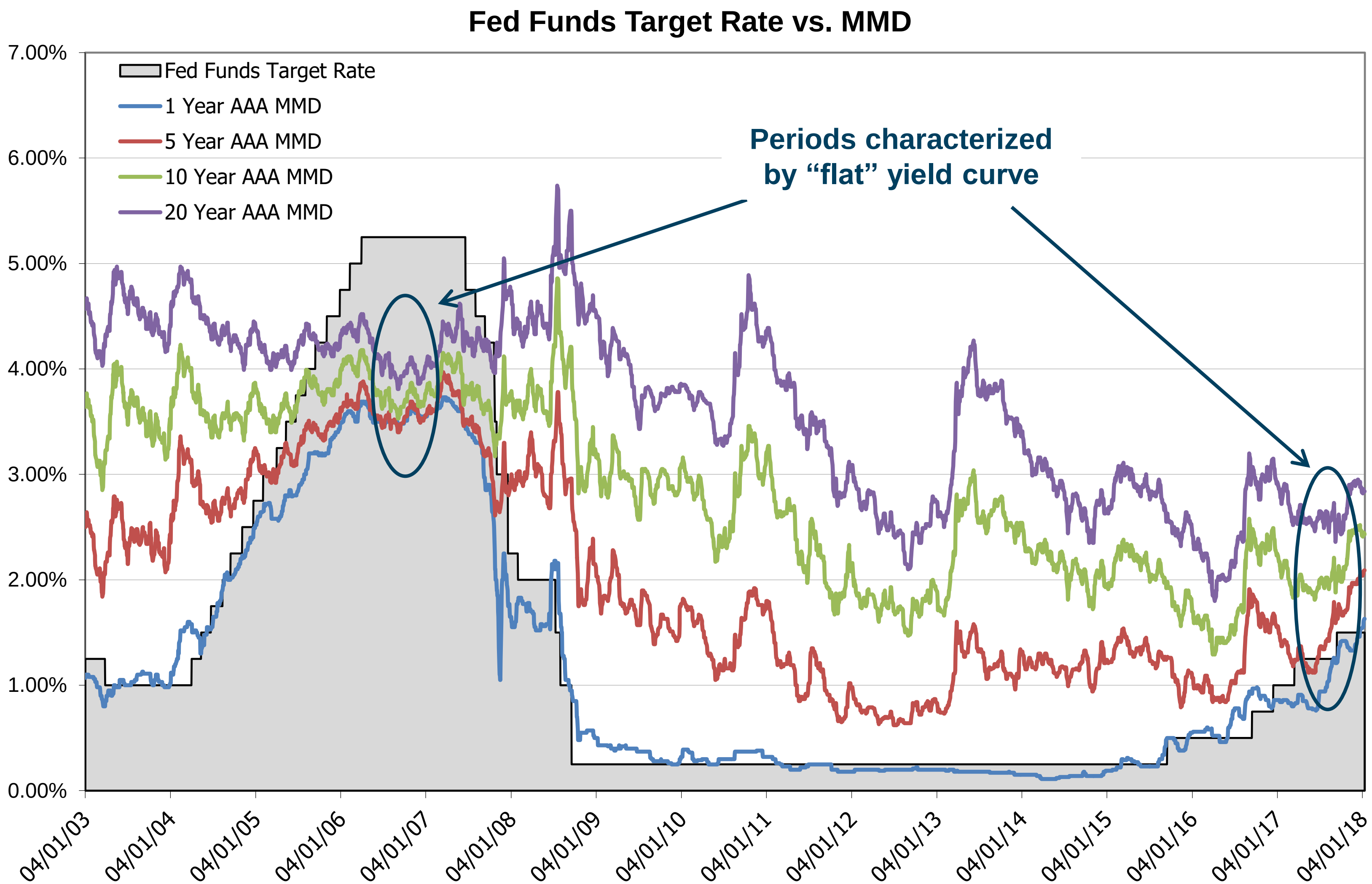
Credit Ratings of State
and Local Governments

Level of Federal and
State Income Taxes

2

- Signed into law by the President on December 22, 2017
- The new law enacts the following:
  - Preserves most tax-exempt private activity bonds (including qualified 501(c)(3) bonds and mortgage revenue bonds)
  - <u>Repeals the use of tax exempt advance refundings, effective Dec. 31, 2017; no transition period provided</u>
  - Repeals tax-credit bonds (including qualified zone academy bonds and clean renewable energy bonds), effective Dec. 31, 2017
  - Preserves the sale of tax-exempt debt for financing professional sports stadiums

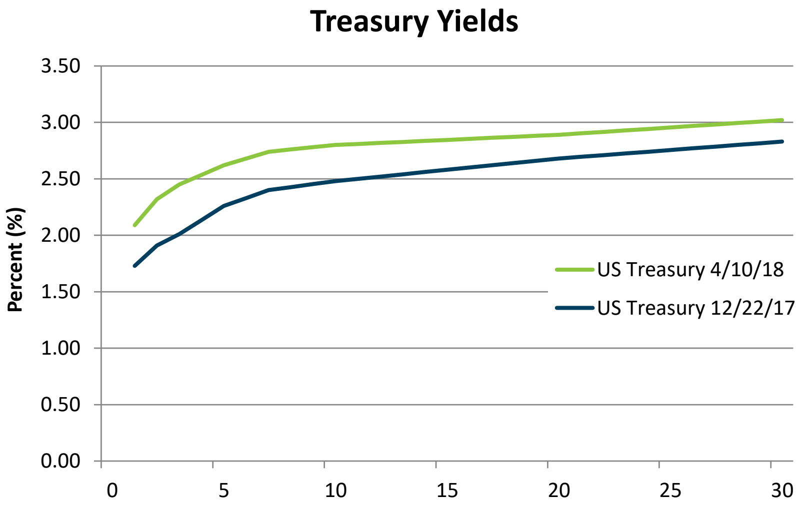
- Additionally, the law:
  - Repeals the Alternative Minimum Tax (“AMT”) for corporations, but it remains for individuals
  - Reduces the Corporate Income Tax from 35% to 21% (effective 2018)
  - Creates 7 individual tax brackets- ranging from 10% to 37%
  - Aggregate of $10,000 limit will apply to the deduction for state and local income, property and sales taxes
  - Interest deductible on mortgage loans of $750,000 or lower

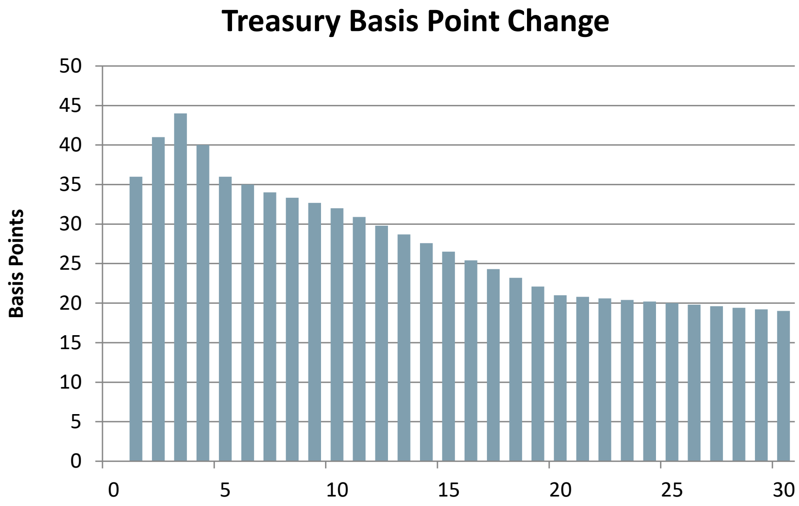


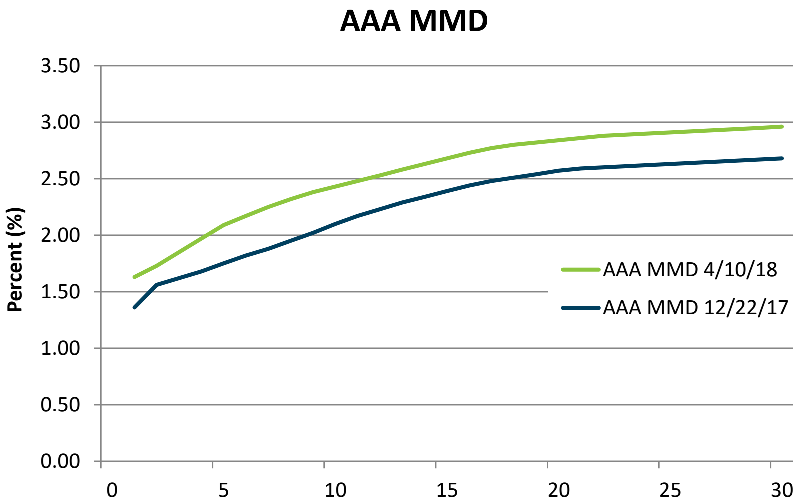
*The Municipal Market Data “MMD” is a AAA municipal bond market index produced by TM3. As of April 10, 2018.

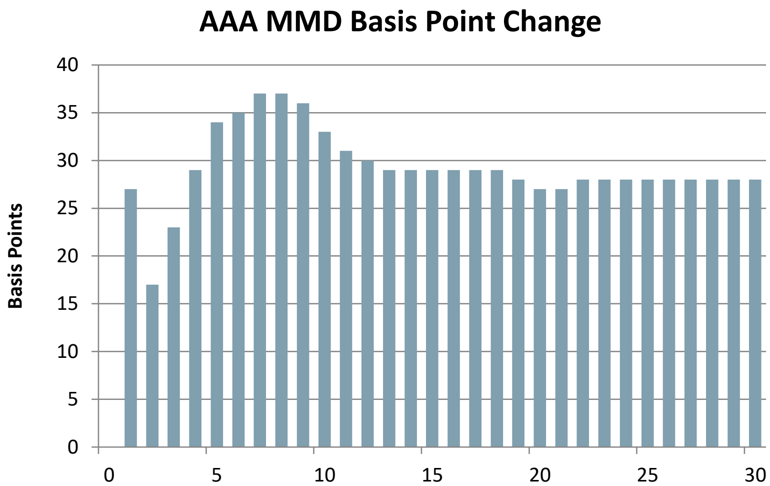
Fed Funds Target Rate from U.S. Department of Treasury.

POST REFORM MARKET: YIELD CURVE DYNAMICS





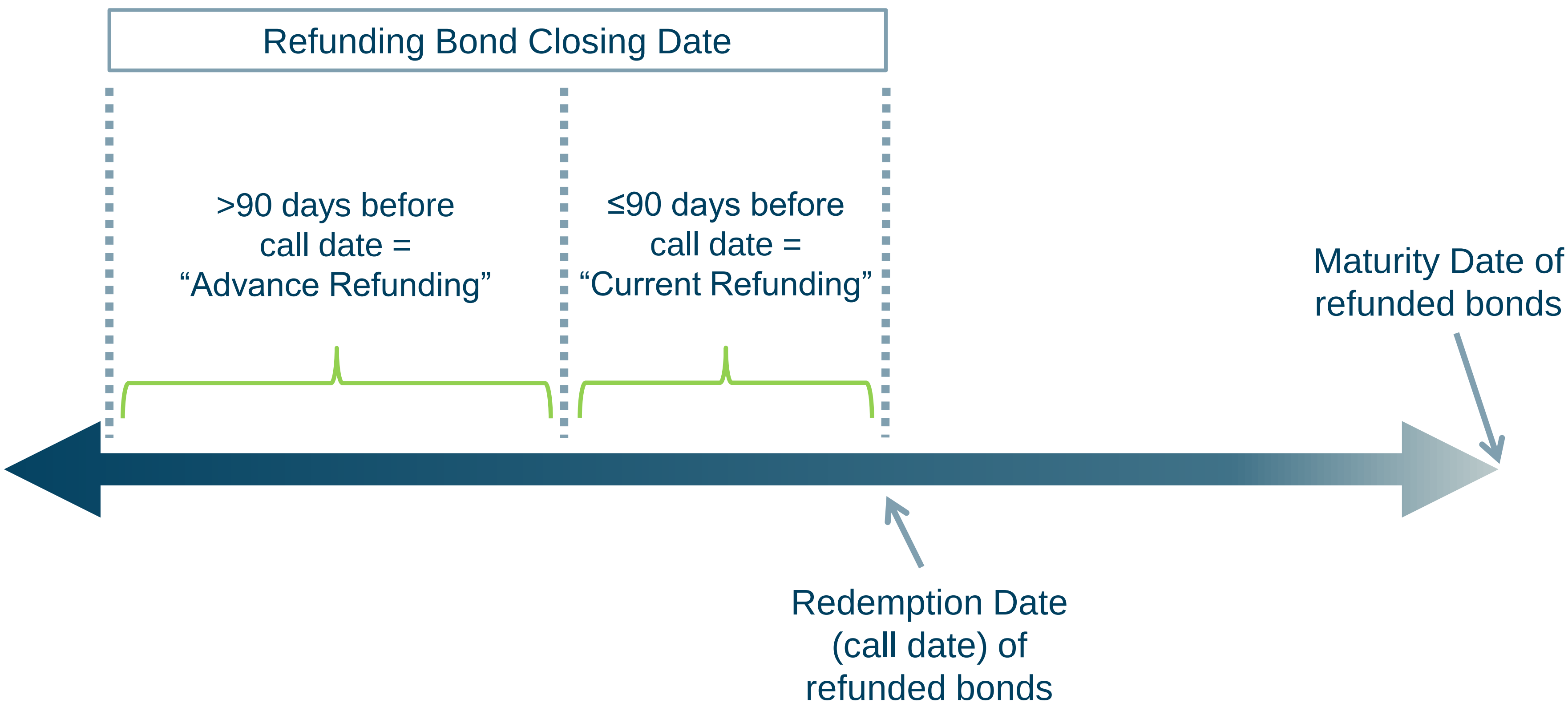




*The Municipal Market Data “MMD” is a AAA municipal bond market index produced by TM3.

Daily Treasury yield curve rates from www.treasury.gov.

- An advance refunding is a bond issue that closes more than 90 days before the redemption date on the refunded bonds



OPTIONS

To Refund Outstanding Bonds:

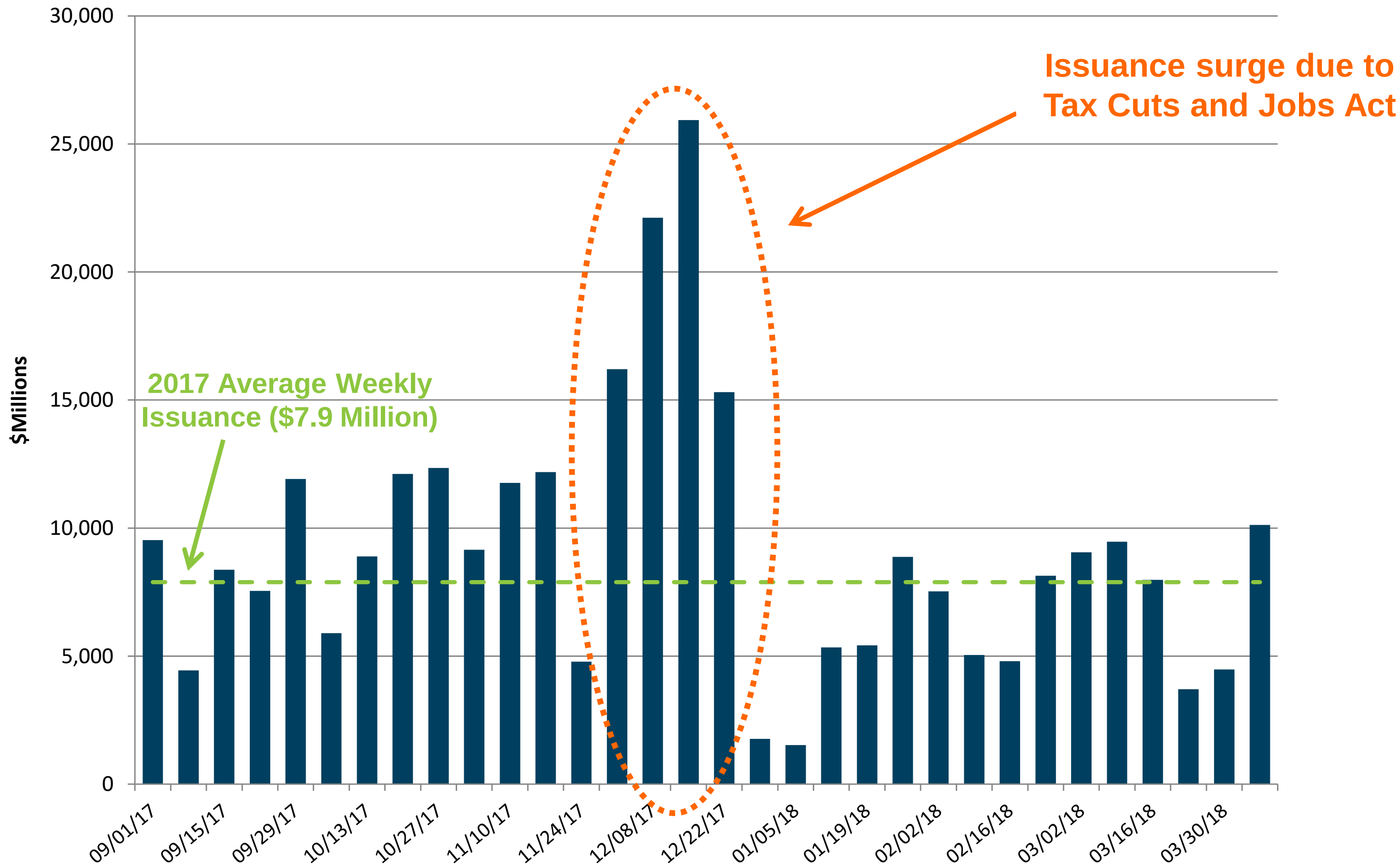
- Wait (until 90 days before call date)
- Advance Refund Taxably
- Forward Settlement Tax-Exempt Current Refundings (within 90 days of call date), also known as a "rate lock"
- Taxable Convertible "Cinderella" Bonds
- Derivative Products (i.e., Swaps, Swaptions)

To Preserve Future Refunding Flexibility on Newly-Issued Bonds:

- Short Par Calls (under 9-10 years)
- Make Whole Calls
  - Call at any time based upon calculation
- Combine "Par Call" with "Make Whole"

Potential Effects of Tax Reform on the Muni Market

- National municipal bond issuance has markedly decreased since tax reform was implemented



*Source: Bloomberg

POSSIBLE EFFECTS ON INVESTORS

- Corporate tax rates being reduced to 21% from 35% will make municipal bonds less attractive to insurance companies and banks
  - These buyers will be at higher relative yields, but still buyers
  - Their reduced participation, specifically in the belly of the curve, may likely result in some yield curve steepening
- Other municipal investors:
  - Individual Retail: Increased demand for tax-free munis due to the loss of various deductions
  - Professional Retail: Buy on behalf of individual investors
  - Arbitrage accounts: Ratio driven/opportunistic buyers who will be mindful of, but not beholden to, the new benchmark entry points of insurance companies and banks as that evolves from past norms
- *Will the expectation of a reduction in municipal supply offset the loss of participation by significant institutional investors?*

- Bank private placements have traditionally been cost effective for several reasons:
  - Lower costs of issuance avoiding bond rating and preparation of formal offering document
  - Bank appetite for tax-exempt income
  - Bank qualification, which allows banks an extra tax benefit for purchasing the bonds of small issuers
- The lower tax rate on corporations (including banks) reduces demand for municipal bonds; in fact, many banks have stated that the returns they will demand are between .35% and .50% higher
- Depending on the size and length of maturity of the bond issue and the rating of the issuer, a public offering (competitive or negotiated sale) may result in more favorable results

POSSIBLE EFFECTS ON COMMUNITY COLLEGE ISSUERS ,CONT.

- Most municipal issuers will likely see increased cost in managing their debt capital structure
- Tools to potentially, somewhat mitigate tax reform impact on advance refundings:
  - Forward Delivery Bonds – Cost is driven by the shape of the yield curve, but only has limited applications.
  - Shorter Calls – Not a demand issue as investors will buy at certain levels however, this optionality may be costly.
  - Taxable Bonds – Can be used to advance refund tax-exempt bonds, although more costly.
- Community colleges will need to work with their financial advisor to customize solutions which meet their financial goals, risk tolerances, etc.

Predictions

- Lower Municipal Bond Supply
  - Both tax-exempt and taxable
  - Strong investor demand could moderate upward interest rate pressure
- Credit Spreads Continue to Decrease
  - Investors see value in Municipals vs. Corporate/Treasuries
- Flattening Yield Curve Means Reduced Cost to Extend Debt
  - Promotes cost effective financing of long-term capital
  - Reduces cost of debt structuring for tax levy management
- Constructive Tension on Tax-Exempt Interest Rates
  - Will Lower Supply Decrease Rates or Lower Marginal Tax Rates Increase Rates?

2018 Challenges Look Similar to Those of 2017

- Market focus is on higher rates, increasing inflation, debt ceiling issues, and Fed activity
- The effects of the new tax law may not be fully known until well into 2018
- *Will markets really look different or is it just a different version of the same thing?*

Current Market Themes

- As they have historically done, Treasury & Muni markets will likely continue to react to geopolitical events
- It is unknown whether the anticipated diminished demand by bank and insurance companies for munis will be offset by the elimination of advance refunding supply
- Regarding the Fed and its new Chair, news reports anticipate at least two more rate hikes during 2018, which will likely result in a flattening yield curve

This presentation has been prepared by PMA Securities, Inc. for informational and educational purposes to units of local government without regard to any particular entity's investment objectives, financial situation or means. The content of this presentation is not to be construed as a recommendation, solicitation or offer to engage in an issuance, or to buy or sell any security, financial product or instrument, or to participate in any particular trading strategy in any jurisdiction in which such an offer or solicitation, or trading strategy would be illegal. Nor does it constitute any legal, tax, accounting or investment advice of services regarding the suitability or profitability of any security or investment. PMA and its employees do not offer tax or legal advice and any entity should consult with its own tax and/or legal advisors before making any tax or legal related investment decisions.

Although the information contained in this presentation has been obtained from third-party sources believed to be reliable, PMA cannot guarantee the accuracy or completeness of such information. It is understood that PMA is not responsible for any errors or omissions in the content in this document and the information is being provided to you on an "as is" basis without warranties or representations of any kind. The analysis or information presented in this presentation is based upon current market conditions which are subject to change. There is no guarantee that the projected yield will be realized and the actual yield will depend on the available investment product and market conditions at the time of investment.

This presentation is solely intended to suggest/discuss potentially applicable financing applications or investment strategies. Any terms discussed herein are preliminary until confirmed in a definitive written agreement. Although market value, market analytics and other information contained in this presentation have been obtained from third-party sources believed to be reliable, PMA cannot guarantee the accuracy or completeness of such information. No representation is made that any results indicated herein will be achieved. Changes to any prices, levels, or assumptions contained herein may have a material impact on results. Any estimates or assumptions contained herein represent our best judgment as of the date indicated and are subject to change without notice. Examples are merely representative and are not meant to be all-inclusive. All investments mentioned herein may have varying levels of risk, and may not be suitable for every investor. Investment in securities involves risks, including the possible loss of the amount invested. In addition, past performance is no indication of future results and the price or value of investments may fluctuate. Asset allocation does not assure or guarantee better performance and cannot eliminate the risk of investment losses.

Securities, public finance services and institutional and municipal advisory brokerage services are offered through PMA Securities, Inc. PMA Securities, Inc. is a broker-dealer and municipal advisor registered with the SEC and MSRB, and is a member of FINRA and SIPC. Prudent Man Advisors, Inc., an SEC registered investment adviser, provides investment advisory services to local government investment pools and separate accounts. All other products and services are provided by PMA Financial Network, Inc. PMA Financial Network, Inc., PMA Securities, Inc. and Prudent Man Advisors (collectively "PMA") are under common ownership.