HOT TOPICS IN THE MUNICIPAL BOND MARKET

ILLINOIS COMMUNITY COLLEGE
CHIEF FINANCIAL OFFICERS
SPRING CONFERENCE

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• Bond Market Conditions

• Rating Agencies’ Focus

• Municipal Advisor Rule
• The Municipal Market Data (MMD) Index is a daily index of AAA-rated municipal bond rates

• Issuers’ bonds are priced relative to the MMD
  • At a “spread” to the MMD
Past performance is not an indication of future results.

Municipal Market Data as of April 7, 2015
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HISTORICAL INTEREST RATES

- 0.00%
- 0.50%
- 1.00%
- 1.50%
- 2.00%
- 2.50%
- 3.00%
- 3.50%
- 4.00%
- 4.50%

1 Year
5 Year
10 Year
15 Year
20 Year

Municipal Market Data as of April 7, 2015
Current Rate is the MMD 20-year rate as of 04/07/15.

Data encompasses MMD 20-year rates between 01/02/90 and 04/07/15. Past performance does not guarantee future results.

Source: The Municipal Market Data “MMD” is a AAA municipal bond market index produced by TM3.
NUMEROUS VARIABLES IMPACT THE MUNICIPAL BOND MARKET

The FED and Quantitative Easing

Inflation Expectations

State of Illinois Fiscal Challenges – Pension Situation

Municipal Bond Supply and Demand

Chicago’s Fiscal Challenges

Credit ratings of state and local governments

Budget and Credit of the US Government

Health of national, state and local economies

Bank Qualification

Europe

Detroit

Level of federal and state income taxes

The Municipal Bond Market
The greatest benefit for BQ deals is usually seen in the 10-year to 20-year range of the curve.
• The FED’s term for buying bonds and other assets in order to push more money into the economy

• The FED wanted to drive up the available supply of money for loans, driving down long term interest rates so more people would buy and build homes and invest in businesses

• With short term interest rates already near zero, the FED’s traditional tool couldn’t be pushed any farther

• The FED began phasing out QE 3 in December 2013
  – Ended in the fall of 2014
The 4th quarter GDP report was consistent with market expectations (2.2% increase)

The March Manufacturing ISM report was also generally positive
  – 27th consecutive month of growth in the manufacturing sector

Unemployment rate is now 5.5%
  – Seven-year low
  – Although the participation rate is at 62.70%

March employment report showed a gain of 126,000 jobs (non-farm payroll)

How has the FED responded recently?
  – It will no longer be “patient”
The municipal bond market is approximately $3.7 trillion
  - Nearly half of it is owned by individual investors, though at the lowest levels since 2007

Demand for new municipal bonds was low in 2013
  - Municipal bond funds reported record outflows of nearly $63 billion
  - Investors wanted to limit their exposure to volatility in municipal bonds

In mid January of 2014, municipal bond funds had net inflows for the first time since May 2013
  - Saw net outflows last week

In an average week, between $5 billion and $6 billion of municipal bonds are sold
  - Weekly average was between $3 billion and $4 billion throughout 2014

Average weekly supply since the beginning of February 2015 has been approximately $9 billion
• Key variables in a municipal credit analysis
  • Management
  • Local economy
  • Financial position
  • Debt position

• Higher credit rating = lower cost of borrowing
The Municipal Market Data “MMD” is a municipal bond market index produced by TM3. As of April 7, 2015.
• Illinois has the lowest credit rating of any state in the country

• The pension crisis has directly impacted local issuers in Illinois

• Some investors will no longer buy bonds from any issuer in Illinois

• The City of Chicago’s unfunded pension liability and deficit budgets also caused a “triple notch” Moody’s downgrade on its general obligation bonds to A3 last year
  – The City’s bonds are rated “Baa2”
  – Chicago Public Schools’ credit rating is now “Baa3”
The Illinois penalty in 2022 is currently 0.65%.

*The Municipal Market Data “MMD” is a municipal bond market index produced by TM3. As of April 7, 2015. Information is subject to change due to market conditions.
• Know the development that is taking place within your boundaries
• Understand the status of existing TIFs and the possibility for additional TIFs
• Talk to the county assessor(s) about expected EAV trends
• Know the status of significant property tax appeals (PTAB)
• Understand your OPEB liability
• Be ready to explain the College’s revenue raising flexibility
  – How close are you to the tuition cap?
• Be well-versed in your fund balance policy
• If you don’t have them in place, develop a debt management policy and a capital improvement plan
• Understand how close the College’s individual tax rates are close to the statutory maximum rates
• Be prepared to provide year-to-date budget-to-actual numbers
• Be ready to disclose direct-purchase debt
• Have you built a potential pension cost shift into your financial projections?
Due to the Dodd-Frank Act of 2010, a financial advisor has a fiduciary duty to act in the best interest of its clients:
- Disclose all material conflicts of interest
- Review and provide inquiry into reasonable financial alternatives to the financing
- Act in the issuer’s best interest without regard to financial and other interests of the municipal advisor (“MA”)

Underwriters are not subject to a fiduciary duty.

The roles of an underwriter and financial advisor are definitive, separate roles.
MUNICIPAL ADVISOR DEFINITION TIMELINE

- July 21, 2010 – Dodd-Frank Act Signed
  - Amended Section 15B of the Securities Exchange Act of 1934
  - Includes Section 975 – Regulation of Municipal Securities

- October 1, 2010 – Temporary Rules
  - Required “Municipal Advisors” to register with SEC & MSRB
  - About 1,150 municipal advisors registered

- December 20, 2010 – SEC Proposed Rules with Concerns
  - Treatment of appointed board members of municipal entities
  - Investments of all municipal funds (versus bond proceeds)
  - Impact on traditional banking activities
  - Lack of guidance on what is “advice”

- September 18, 2013 – Final Rules Adopted
  - Rules effective January 13, 2014

- July 1, 2014 – Effective Date
• Underwriters may provide advice on the structure, timing, terms, and similar matters concerning a transaction under the “underwriter exemption”
  – Only during the period of time beginning when they are engaged for a particular transaction and ending at the end of the underwriting period

• Outside of a specific engagement, underwriters may also provide further advice
  – When the government has hired an independent MA for the specific transaction
  – “RFP” exemption applies
  – Underwriters may also provide many other types of information to municipal entities (including general market information and information about their qualifications) that does not rise to the level of advice without acting as a municipal advisor
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