

# Hot Topics: Debt Management

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# What about Build America Bonds?

Sure, the net borrowing costs are attractive,  
but . . .

- Are you going to get your subsidy payment?
  - Offsets
  - Subsidy payment risk
- Are you more likely to be audited by the IRS just because you issued BABs?

# Increased Attention to Municipal Disclosure

- New disclosure rules (15c2-12) take effect December 1, 2010
- Issuer concerns about new material event requirements did not result in changes to original SEC proposals
- “Voluntary” 120 day filing standard

# Rating Recalibration

- Too soon to know how higher ratings will affect the cost of borrowing
- Bonds that have jumped from “Baa/BBB” to the “A” category may realize greater benefit initially

# Bid Rigging, Pay-to-Play and other Not-so-Nice Things

- "State Finances Rigged in Conspiracy by Banks, Advisers" Bloomberg.com, May 18, 2010
- Jefferson County, AL Pay-to-Play, et al.
- Is Bond Flipping the next big thing?

# GFOA Debt Committee Update

- Build America Bonds
  - What advice should GFOA be giving to members?
  - Responding to the “The Questionnaire”
  - Issue Price Certificates
- New Disclosure Rules (15c2-12)
  - Material Events
  - Voluntary Disclosures
- New Best Practices and Advisories
  - Need for new BP’s and Advisories tailored to needs of smaller issuers

# Three Wishes for the Municipal Market

- Modify MSRB Rule G-23 – PROHIBIT firms from switching from financial advisor to underwriter in the middle of a financing
- Reduced reliance on negotiated sales. Greater adherence to GFOA Best Practices on choosing the method of sale and selecting financial professionals.
- Real bond pricing transparency. Elimination of NRO masking of bond yields on new issues.



# Municipal Investment Group

GFOA Annual Conference

## Hot Topics in Debt Management

### Investor's Perspective

Mark Stockwell  
Director of Municipal Research  
PNC Capital Advisors



## **Wearing Two Muni Analyst Hats:**

- **Provider of Opinions of Credit Quality and Investment Analysis for PNC Muni Investors,**
- **Spokesman for National Federation of Municipal Analysts (NFMA) Disclosure and Muni Policy Initiatives as Chair**

# NFMA Policy Positions

## 1) Effective and Timely Disclosure Key to Integrity in the Muni Market

- Not Just for Investors but Will Also Help Issuers
- Evidence by Recent Dramatic Changes in the Market
- NFMA Initiatives

## 2) Ratings and Ratings Calibration

- Focus should be on Improved Disclosure not Legislative Directives on a Rating Scale
- No Consensus from the Analyst Community on the Preference of a Rating Scale

# Buy-Side Muni Analyst Perspectives

- 1) Dramatic Changes to Muni Ratings Started Well Before the Recent Recalibration:**
  - **Downward Migration of High Grade Ratings Due to Bond Insurer Downgrades and Limited Supply of Enhancers**
  - **Muni Scale Preference from Traditional Muni Investors**
  - **Pricing Differentiation Between Similar Rated Munis**
  - **Pricing Impacts from Recalibration May be Mitigated by Other Factors**



## **2) The Cost of Foregoing Quality and Timely Disclosure Has Increased as Muni Market Has Changed:**

- Fewer Bond Insurance Analysts and Restrictions to Access of Sell-Side Analysis**
- Importance of Underlying Credit Characteristics has Increased Dramatically**
- Increasing Global Participation in the Muni Market Has Created Demand for Better Understanding of Muni Credit Factors**



### **3) Build America Bonds Are Contributing to the Transformation of the Muni Market:**

- **Demand for Analytical Capabilities**
- **New Investment Products are Emerging**
- **Who is Responsible for Managing and Analyzing BAB Holdings in a Portfolio?**
- **BABs Impact on Supply of Tax-Exempt Debt Can Impact State-Specific Bond Funds**

#### **4) Muni Buyers Are Being Pulled in Two Directions:**

- Concern for Credit Quality Should Help High-Grade State and Local G.O. Issuers, but Demand for Yield Fueling Returns of Lower Quality Bonds**
- Portfolio Core: Basket of High-Grade, Stable, Tax-Backed or Essential Service Bonds**
- Price Differentiation within Rating Categories Provide Buying Opportunities**



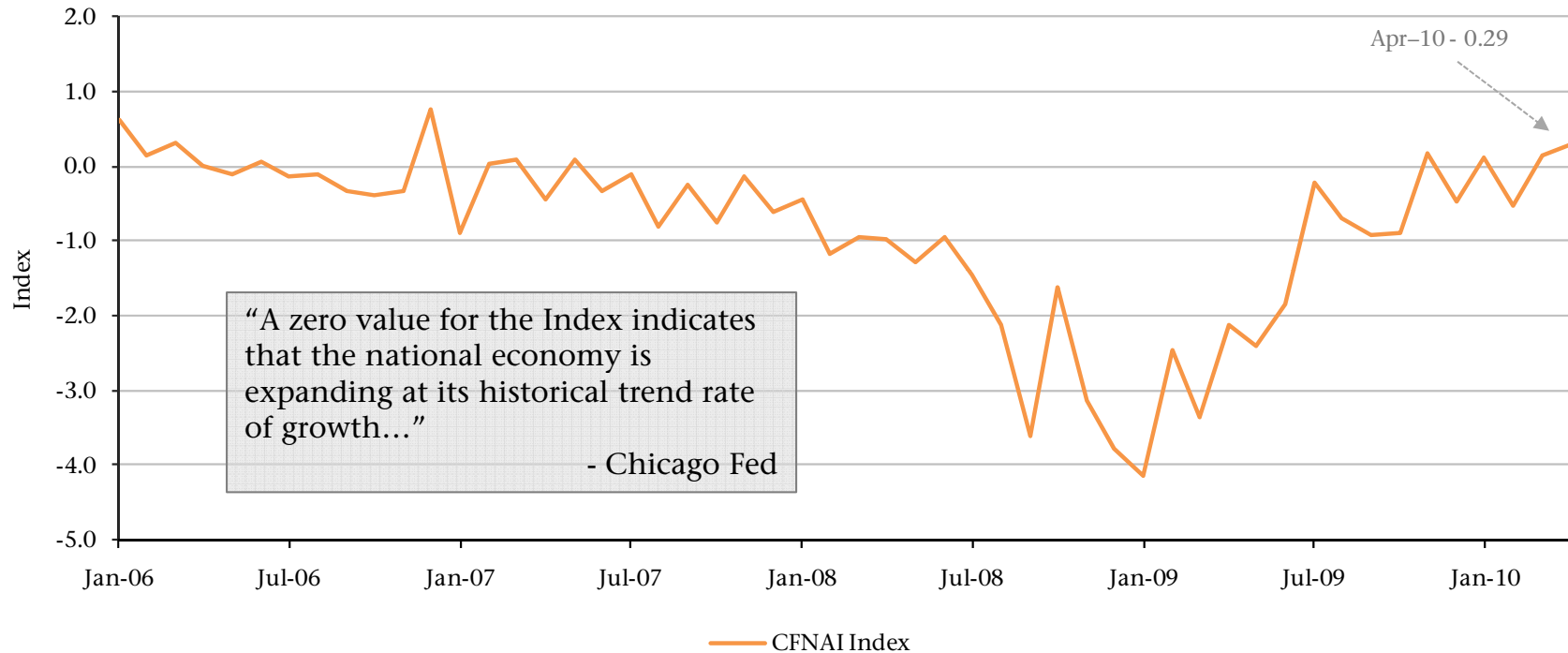
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**Chris Mier**  
Managing Director, Strategist  
Loop Capital Markets LLC

# Recovery is Alive and Well

Chicago Fed National Economic Activity Index (CFNAI)

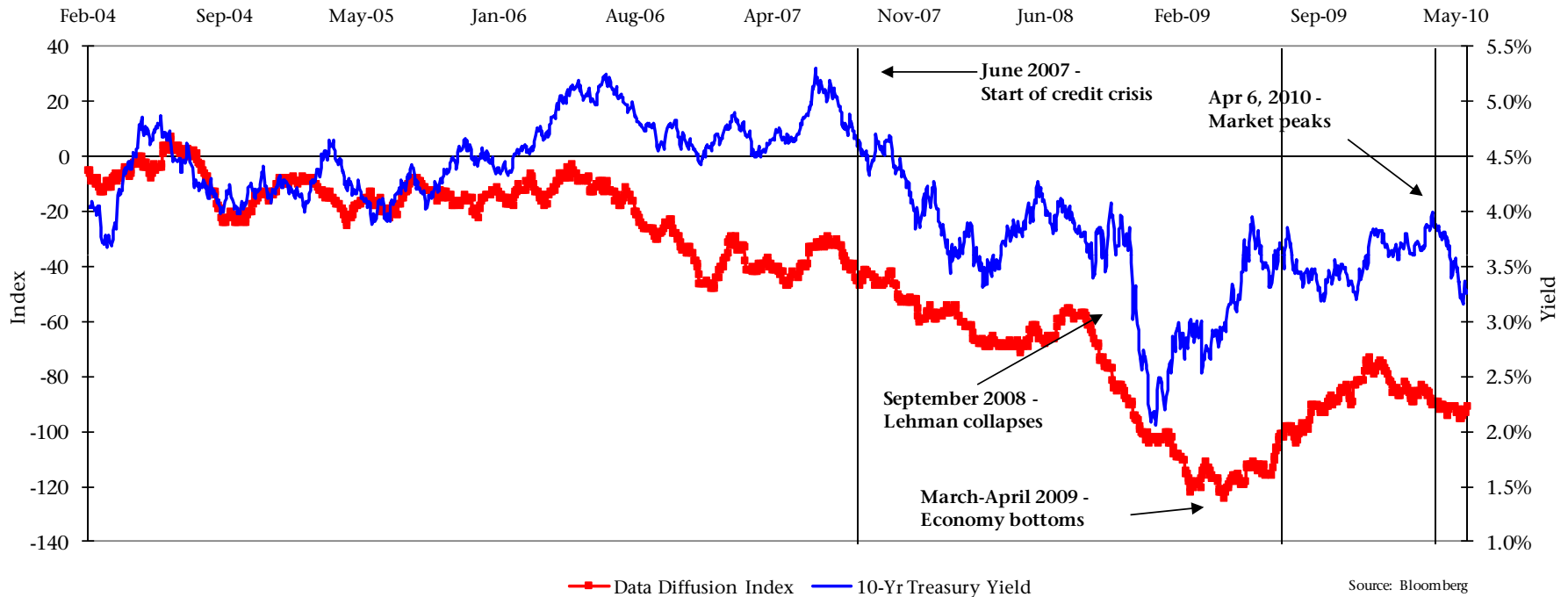


- The economic recovery will slow in 2011, but will nonetheless withstand Greece, Portugal, and other financial market calamities

Source: Bloomberg

# Recovery is Alive and Well

Data Diffusion Index vs. 10-Yr Treasury Yield



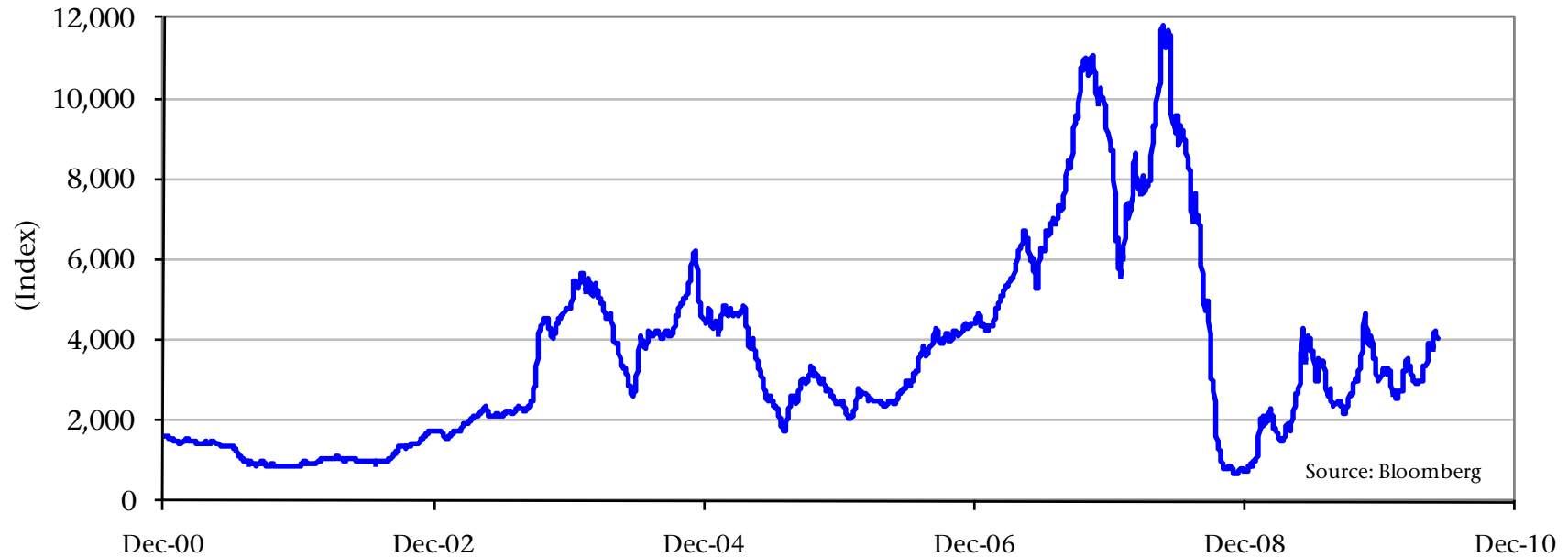
- Economists have been too negative on the economy since the recession started
- The talk of W-shaped, L-shaped, and U-shaped recessions is almost gone – it's a V-shaped recession

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# Recovery is Alive and Well

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Baltic Dry Index



- Nice and steady improvement on one of Greenspan's favorite indicators

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## Is There a “New Normal”?

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- **There never was a “normal” to begin with**
  - ‘Great Moderation’ gave way to ‘Great Recession’
- **Economic, finance and social science relationships are always evolving and never stable in the long run**
- **Population growth, technological advancements, and the right set of policy choices could produce growth as fast as, or faster, than before**
  - However, the current excess debt problem requires a temporary reduction in our standard of living

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## What Should the Market be Thinking About Regarding the Future?

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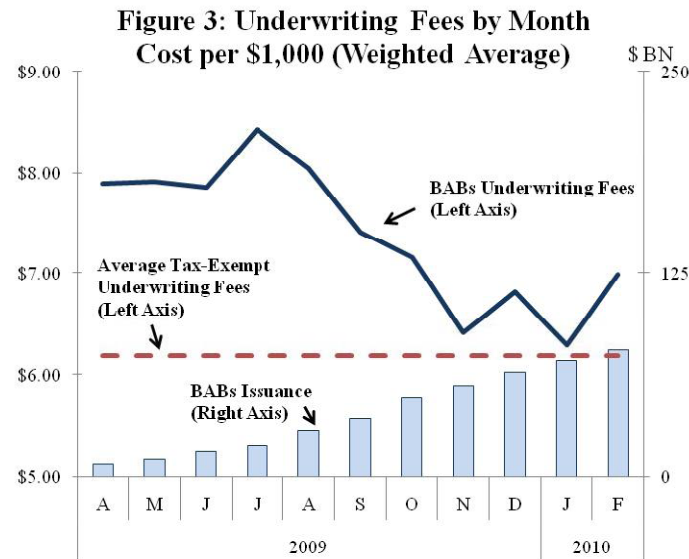
- How do I manage my way through a continual change in debt instruments, market participants, municipal market culture, and regulations?
- As an issuer, how do I build in flexibility in case something (or someone) craters?

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## Underwriting Spreads, Rating Agencies, and BABs

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- Treasury study shows narrowing of BABs/Tax-Exempt underwriting spreads



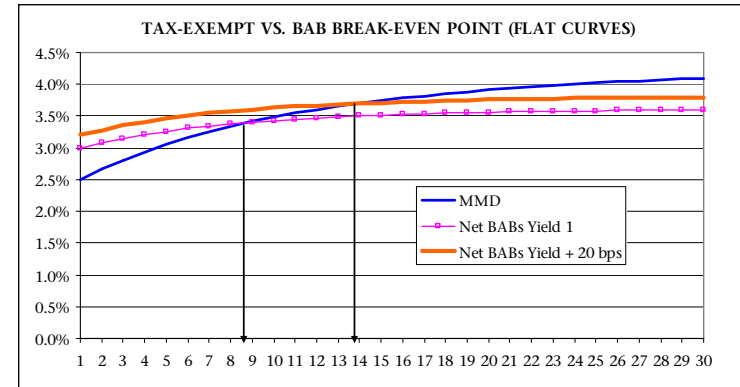
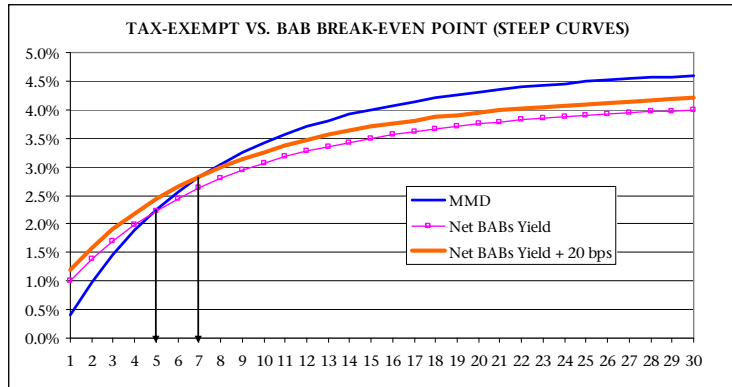
Source: U.S. Treasury Dept. BABs Analysis April 2010

- The Rating Agencies and their business model: There is a simple answer, but the federal government is not likely to find it
- Build America Bonds
  - Most issuers love BABs, the federal government is conflicted
  - Controversy regarding offsets, secondary trading, maximum coupon, federal auditors dampens market's enthusiasm

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## Sliding Down the BABs / Tax-exempt Pivot (as curves flatten)

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- A flatter yield curve for both the municipal and the BABs market means that a parallel shift in one curve has a much larger impact on the BABs/Tax Exempt mix than was the case in 2009.
- Will the swings in volume be large enough to impact the functioning of the muni market?

# Questions?

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