

CPIM

CENTER FOR PUBLIC INVESTMENT MANAGEMENT



A PROGRAM BROUGHT TO YOU BY:

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FINANCE 401:

**HOT TOPICS IN
MUNICIPAL FINANCE -
ADVANCED CONCEPTS IN
TODAY'S MUNICIPAL
MARKET**

2013 CPIM Academy



FINANCE 401: HOT TOPICS IN MUNICIPAL FINANCE – ADVANCED CONCEPTS IN TODAY'S MARKET

2013 CPIM Academy

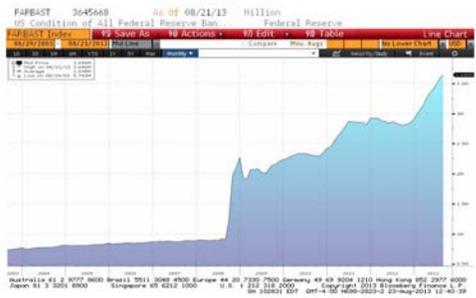
Market Update

- The last several years have seen historic levels of volatility and lows in the interest rate markets.
- The Federal Reserve and other Central Banks continue to maintain an aggressive stance with regard to interest rates and money supply, although with caution.
 - Fed Statement on March 20 suggested continued buying under Quantitative Easing until there is "substantial" improvement in the labor market
 - The Federal Reserve is purchasing \$85 Billion per month.
 - However, on May 22nd, Bernanke discussed the possibility that the Fed may begin reducing purchases as soon as and IF new Fed projections are realized.
 - The market responded with an immediate increase in rates fearing a "Tapering" of purchases sooner, rather than later.

Market Update

- General consensus was for rates to remain low for the next year although recent Fed comments have refocused bond investors on potential reduction in Fed purchases.
 - Recent talk has focused around housing strength, labor market improvement, and rotation out of Bonds and into Equities.
 - Fed testimony in late May indicated that they could begin to reduce purchases as soon as this summer.
 - At the same testimony, the Fed also reiterated that the economy needs to further strengthen before they would begin winding down the asset purchases creating confusion in the bond market and an increase in rates of approximately 30 basis points in only two weeks.
 - June 19th Fed testimony reinforced the talk of tapering, but regional Fed governors have been quick to reinforce the message that it will only occur with sufficient growth in the economy.
 - 10 Year Treasury is up approximately 125 basis points since May 2nd
 - Current expectations are for "tapering" to begin in Mid-September.

Federal Reserve Balance Sheet Continues to Grow



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3.646 Trillion as of 8/21/2013

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US Single Family Home Starts are Increasing but Well Below Normal



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Average Home Affordability Remains Near All-Time Highs, But is Falling

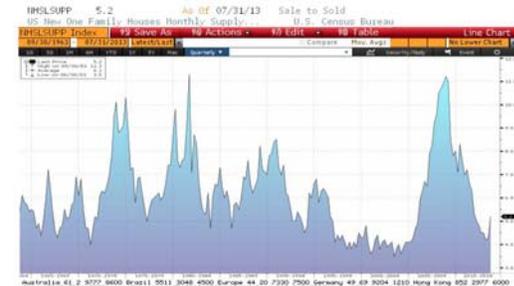


Values are off the highs due to recent increase in rates.

- A value of 100 means that a family with the national median income has exactly enough income to qualify for a mortgage on a median-priced home.

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Result is Lower than Average Housing Supply, Now Approaching Average



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Economists Calling for Moderate Growth/Slight Increase in Long Rates

<HELP> for explanation, <MENU> for similar functions.
 #Go for Details

Country/Region/world: United States
 Contributor: Federal Reserve
 Component: Economic Forecasts
 Frequency: Yearly
 Units: Private Official

Country	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Economic Activity										
Real GDP (YoY%)	2.70	1.80	-0.30	-2.80	2.50	1.80	2.80	1.60	2.70	3.00
GDP (YoY%)	3.23	2.87	3.95	-0.95	1.63	3.17	2.08	1.60	1.90	2.15
Core PCE (YoY%)	2.24	2.16	2.06	1.19	1.29	1.44	1.84	1.30	1.70	1.90
Unemployment (%)	4.60	4.60	5.80	9.30	9.60	8.90	9.10	7.50	7.00	6.40
External Balance										
Cur. Acct. (% of GDP)	-5.74	-4.93	-4.63	-2.65	-3.00	-2.95	-2.71	-2.70	-2.60	-2.50
Fiscal Balance										
Budget (% of GDP)	-1.90	-1.20	-3.20	-10.10	-9.00	-8.70	-7.00	-4.10	-3.70	-3.40
Interest Rates										
Central Bank Rate (%)	5.25	4.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	-
3-Month Rate (%)	5.30	4.70	1.40	0.25	0.30	0.50	0.31	0.30	0.44	-
2-Year Note (%)	4.81	3.05	0.77	1.14	0.60	0.24	0.25	0.45	0.88	-
10-Year Note (%)	4.70	4.03	2.21	3.84	3.30	1.88	1.76	2.77	3.23	-
Exchange Rates										
EURUSD	1.32	1.46	1.40	1.43	1.34	1.30	1.32	1.27	1.25	1.28

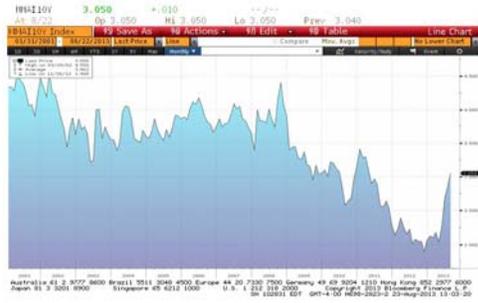
Fed Forecast Calls for Higher GDP & Lower Unemployment by End of 2013

<HELP> for explanation.
 #Go for Details

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Exchange Rates										
EURUSD	1.32	1.46	1.40	1.43	1.34	1.30	1.32	-	-	-

10-Year Muni Rates are Still Low, But Well off Recent Lows



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Summary

- Conditions continue to improve in the United States, with signs of life in the housing market, the major contributor of the initial economic fall in 2007 and 2008.
 - Housing and consumer confidence are at levels last seen prior to the recession
 - The Fed is carefully monitoring the economy for additional signs of growth and will begin to reduce stimulus as conditions improve
- While off recent lows, the remainder of 2013 and possibly into 2014 should continue to present a favorable borrowing environment for governmental issuers although rapid rate movement is possible.
 - Tax-Exempts should begin to move up less than Treasuries as rates rise
- Monitor the impact of QE3 for potential inflation and signs of higher rates.
 - Look to borrow for New Projects sooner rather than later and refund prior bonds if the market presents itself again - watch as negative arb declines as you get closer to call date
- The Bond Market may start to increase long-term rates faster than anticipated as the Fed begins to exit QE due to an improving economy.

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Hot Topics: Federal Tax Law

Sequestration

- IRS is reducing Federal subsidy payments claimed by Issuers on IRS Form 8038-CP (approximately 8.7% reduction)
- Affects Tax Credit Bonds: Build America Bonds (BABs), Recovery Zone Economic Development Bonds (RZEBs), Qualified School Construction Bonds (QSCBs), Qualified Zone Academy Bonds (QZABs), New Clean Renewable Energy Bonds (New CREBs) and Qualified Energy Conservation Bonds (QECBs)
- Sequestration will run through September 30, 2013 without future Congressional action.

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Hot Topics: Federal Tax Law

- Refunding Tax Credit Bonds
 - No explicit authority to refund Tax Credit Bonds
- IRS Ruling on Special Purpose Districts

Hot Topics: Federal Securities Law

Continuing Disclosure Undertakings

- Rule 15c2-12
- Issuers must use EMMA to file 1) [annual information](#), 2) [audited financial statements](#), and 3) [event notices](#)
- Failures range in significance:
 - Total failure to prepare and file continuing disclosure
 - Failure to use EMMA to make filings (no more NRMSIRs)
 - Pre-EMMA failures (EMMA is only 3 years old, and Rule 15c2-12 requires that underwriters' review the previous 5 years of filings)
 - Failure to include some piece of data that was required, like a single table that provides property tax data from the Issuer's jurisdiction
 - Bad CUSIPs
 - Late filings (one day late is a failure to comply with Rule 15c2-12)

Hot Topics: Federal Securities Law

Underwriter Due Diligence

- Underwriters are requiring strict compliance with Rule 15c2-12.
- MSRB Rule G-17 requires that Underwriters have a "reasonable belief" that Issuers have accurately disclosed failures to comply with Rule 15c2-12.
- Generally, if you failed to timely file anything within the past 5 years, do not be surprised if an Underwriter requires you to disclose the failure in your offering document.

Hot Topics: Federal Securities Law

EMMA

- MSRB is working on EMMA 2.0
- MSRB is encouraging voluntary disclosures beyond what is required by Rule 15c2-12
- For example: presale documentation, competitive bid notices, POS, financial statement information, GAAP standards, etc.), bank loan disclosures, website URLs
- Until these items are required, Issuers should focus on consistently posting 1) annual information, 2) audited financial statements, and 3) event notices.



Hot Topics: Federal Securities Law

- On May 6, 2013, the SEC issued Release No. 2013-82: "SEC Charges City of Harrisburg for Fraudulent Public Statements"

City of Harrisburg, Pennsylvania (pop. 49,673) was charged with securities fraud *"for its misleading public statements when its financial condition was deteriorating and financial information available to municipal bond investors was either incomplete or outdated."*

Hot Topics: Federal Securities Law

- Foundation of problem was state receivership of City, City guarantee of \$260M facility, default on \$13.9M of debt.
- Violations included:
 - Failure to submit annual information since 2007
 - Failure to submit audited financials since 2007
 - Failure to submit material event notices for defaults
 - Failure to use EMMA properly
 - Adopted budget did not reflect guarantees or defaults
 - Major misstatement of City's credit rating as "Moody's: Aaa" instead of "Moody's Baa1"



Hot Topics: Federal Securities Law

- First time SEC has charged a municipality for misleading statements made *outside of disclosure documents*.
 - City Budget Report
 - Annual and Mid-Year Financial Statements
 - State of the City Address by Mayor



Hot Topics: Federal Securities Law

- On May 22, 2013, the SEC issued Release No. 2013-91: "SEC Charges City of South Miami with Defrauding Investors About Tax-Exempt Status of Municipal Bonds"

City of South Miami, Florida (pop. 11,932) charged with securities fraud for *"defrauding bond investors about the tax-exempt financing eligibility of a mixed-use retail and parking structure being built in its downtown commercial district."*

Hot Topics: Federal Securities Law

- City had lease with developer for parking facility, and under original lease as documented no funds from City bonds could finance any retail development. City revised lease without consulting with bond counsel.
- Foundation of problem was that City ignored advice of bond counsel regarding use of parking structure.



Hot Topics: Federal Securities Law

- Violations included:
 - Violations of IRS rules regarding tax-exempt debt and private business use of bond financed facilities
 - Failure to retain institutional knowledge about tax advice from bond counsel
 - Disclosure documents for subsequent South Miami debt issues failed to disclose problems with parking facility leases
 - Disclosure documents for subsequent South Miami debt issues incorrectly reported that City was in compliance with covenants



Hot Topics: Federal Securities Law

- South Miami paid IRS \$260K and required by SEC to retain independent third-party consultant for 3 years.
- Violation proves that SEC violations can result from IRS trouble.



Alternate Financing Solutions

- An alternative financing solution may include a Direct Bank Purchase of the issuer's securities.
- This is still **DEBT** and must comply with Ohio Constitution and Revised Code.
- Depending upon market conditions and the size and structure of the transaction, an alternative financing solution may provide the optimal structure.

Alternative Financing Solutions

An alternative financing solution **may** provide the following benefits :

1. Timing
2. Ease of Execution
3. Lower Financing Expenses
4. Structuring Flexibility
5. Lower Cost of Funds

Alternative Financing Solutions

Common structuring features associated with alternative financing solutions:

1. 10 year or shorter maturity (generally)
2. Principal amortization
3. Fixed or variable interest rate
4. Tax-exempt or taxable interest rate
5. Various par amounts

Alternative Financing Solutions

Other aspects to consider:

1. Resolutions
2. Bond Counsel Opinion
3. Ratings
4. Disclosure Documents (Official Statement)

Alternate Financing Solutions

- Ohio Public Works Commission (OPWC) Loans
- Ohio Water Development Authority (OWDA) Loans
- State Infrastructure Bank (SIB)
- “Direct Bank Purchase”

General Hot Topics

- Reduction in Assessed Valuation (AV)
 - Impact of AV on Issuer economic strength and credit rating
 - Impact of AV on 10 mill analysis
- Local Government Reform and Shared Services
 - Shared services
 - Shared personnel
 - Mergers
