Managing Debt Today:
A discussion of emerging products, trends, market conditions and regulatory changes impacting municipal market participants.

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October 16, 2014
Overview

- Recent Periods in the Municipal Markets
- Public Market New Issuance Municipal Supply
- Kansas Public Market Municipal Issuance Details
- Long term Municipal Rate Trends
- Shape of Municipal Yield Curve and Historical Distribution of Rates
- Active Municipal Market Investor Composition and Market Liquidity
- Municipal Market Demand
- Public Market vs. Private Market Best Execution
- Considerations Going Forward
# Recent Periods in the Municipal Markets

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<td><strong>Themes</strong></td>
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<td>- Auction rate market collapses</td>
<td>Banks emerge as 3rd largest Municipal bondholders</td>
<td>Inconsistent views on recovery leads to volatility on the long-end</td>
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<td>- Federal stimulus programs aids issuance (ARRA)</td>
<td>Short and long-term rates dip to historical lows</td>
<td>Credit and Global events (e.g. Detroit/Puerto Rico, Europe, Iraq/Syria/Russia, etc.)</td>
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<td>- Bank and bond insurer downgrades</td>
<td>Credit spreads stabilize</td>
<td>Convergence continuing between public and private markets</td>
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<td>- Taxable/crossover buyer participation</td>
<td>FRN and DP markets continue to grow</td>
<td>Clients exploring all markets (direct purchases, tax-exempt, taxable and swap market)</td>
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<td>- Short-term market alternatives emerge</td>
<td>Tax-exempt/ taxable ratios above 100%</td>
<td>Volume decline and investor reach for yield has kept rates low in 2014</td>
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<td>- ARS and VRDNs restructured to fixed rate</td>
<td>- Refundings</td>
<td>- Inconsistent views on recovery leads to volatility on the long-end</td>
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<td>- Taxable and private placement markets readily accessed</td>
<td>- Fixed rate bias (95% of issuance volume)</td>
<td>- Credit and Global events (e.g. Detroit/Puerto Rico, Europe, Iraq/Syria/Russia, etc.)</td>
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<td>- Focus on counterparty risk/exposure (Credit enhancement substitutions Swap terminations)</td>
<td>- Taxable and private placement markets continued to be viable alternatives</td>
<td>- Convergence continuing between public and private markets</td>
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<td>- New money projects accelerated before ARRA sunset</td>
<td>- Other alternative markets tested (FRNs, DPs, Windows, Callable CP)</td>
<td>- Clients exploring all markets (direct purchases, tax-exempt, taxable and swap market)</td>
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<td>- Counterparty fatigue (credit and swap)</td>
<td>- Volume decline and investor reach for yield has kept rates low in 2014</td>
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**PUBLIC MARKET NEW ISSUANCE MUNICIPAL SUPPLY**

- Volume for 2013 was $326 billion, 14% less than 2012. Supply in 2014 is expected to remain below 2013 levels.
- Growth of private market execution has muted the growth of public market securities.
- However, strong June and August calendars have offset the difference to -12% from -25% through May.

**Recent Periods in the Municipal Markets**

**Monthly Municipal Tax-exempt and Taxable Bond Issuance ($mm)**

![Chart showing municipal bond issuance over time]

Source: Bond Buyer
Observations

- Overall volume up 21% year over year – first half of 2014
- 100% of all issuance fixed rate
- Only 2% enhanced with insurance
- Security: General Obligation 60%
- 95% of issuance Tax-exempt
- New Money issuance volume significantly higher than refunding volume
- Largest use of proceeds for Education ($878mm) followed by Utilities ($291mm) and General Purpose ($285mm)
**LONG TERM MUNICIPAL RATE TRENDS**

### Factors that Could Drive Rates Higher
- Better than expected US Economic data
- Indicators pointing to increased Inflation
- Persistent Fed tapering of asset purchases
- Equity market strength
- Rush of new issue volume outweighed by a decline in demand (Bond Fund Outflows)

### Factors that Could Drive Rates Lower
- Weaker than expected US Economic Data
- Potential geopolitical surprises (Europe)
- Dovish Fed Policy
- New issue volume outweighed by strong demand (Bond fund Inflows)
- Long-term rates continue to remain well below their historical averages
- Lack of new issue volume and buyer reach for higher yields have flattened the yield curve
- A flatter yield curve will provide opportunities for longer dated fixed rate borrowing at lower incremental cost to Borrowers
ACTIVE MUNICIPAL MARKET INVESTOR COMPOSITION AND MARKET LIQUIDITY

Market Liquidity

- **High**
- **Moderate**
- **High**
MUNICIPAL MARKET DEMAND

- Bond fund outflows dominated municipal market dynamics in 2013
- In 2013, bond fund outflows total -$37.255 billion. Most recently, Bond Funds have seen 8 straight months of net inflows
- With expectations of higher rates ahead, fixed income funds – including munis – could see net outflows, holding all else constant

Monthly Tax-Exempt Bond Fund Flows ($mm)

Source: Lipper
Public Market vs. Private Market Best Execution

- Trend developing where large issuers pursue private and public market options simultaneously and choose based on best execution.
- Began in Healthcare and Higher Ed, but the number of issuers pursuing private and public options along certain spots on the yield curve is increasing.
- Several recent transactions highlight issuers’ flexibility to execute in a variety of markets:
  - Large municipal issuer planned to sell $328.7 million Water and Wastewater (Aa3/A+/A+) as Floating Rate Notes but due to limited interest and wide spreads at the time of sale, placed the balance ($150 million) as a Direct Purchase.
- More recently occurring with fixed rate transactions.
- Issuers using private market for front of curve (e.g. 1-5yrs), public thereafter.
- Trying to maximize efficiencies in each market.
- Flexibility driving decisions.
CONSIDERATIONS GOING FORWARD

- Impact of Regulatory Environment
  - Municipal Advisor Rule
  - Dodd-Frank
  - Basel III
  - Volker Rule
  - Continuing Disclosure

- Potential tax reform (Corporate tax rates and/or tax-exemption)

- Detroit/Puerto Rico spill off

- Role of private market going forward

- Taxable issuance as an alternative to tax-exempt

- Resurgence of variable rate debt
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