Bloomberg BRIEF

Municipal Market

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Tax-Exempts Extend Yield Decline

BY BRENDAN A. MCGRAIL
AND MATT ROBINSON

New York City Transitional Finance Authority, which helps fund capital projects in the most-populous U.S. city, is selling $875 million in municipal debt amid the longest tax-exempt rally in almost two years.

Yields on top-rated tax-exempt bonds due in 25 years have fallen for nine straight days, the most prolonged since April 2009, according to a Bloomberg Fair Value index. Rates have declined 28 basis points, or 0.28 percentage point, since Jan. 18 to 4.89 percent, while comparable Treasury yields jumped about 4 basis points.

Low issuance in January and increased demand from crossover buyers have helped drive down yields, said **Neil Klein**, who oversees $900 million in fixed-income assets at New York-based, Carret Asset Management.

"Some of the 'doom and gloom' reports have taken a back seat to more factual market research and the muni market is showing resilience," he said in a telephone interview.

In December, speculation by **Meredith Whitney**, the banking analyst, about possible state and municipal bankruptcies began to rattle the $2.86 trillion municipal-debt market. States and local governments sold about $11.9 billion in fixed-rate debt in January, the smallest amount since at least February 2003, according to data compiled by Bloomberg. About $31.9 billion was sold last January.

Crossover buyers, investors typically purchasing taxable assets such as Treasuries and corporate bonds, were drawn to relatively cheap munis in late January, **Citigroup Inc.** strategists led by **George Friedlander**, said in research note yesterday.

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What Not To Buy

BY JOE MYSAK

Until a few months ago, municipal bonds weren't part of the financial culture of the U.S.

Voters considered, states and localities sold, and investors bought them. And then, according to the market axiom, it was: "All bonds go to bond heaven."

You could go days, maybe weeks, without seeing one article even in the financial press about munis. The same was true for business television. I was at Bloomberg for years before producers asked me to appear — a frightening prospect, I agree — and then it was to explain inexplicable stuff like yield-burning and bid-rigging.

Now people can't stop talking about municipal bonds, even on national network television.

This doesn't mean they know what they're talking about. During the past year, I have read or heard assertions and

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BLOOMBERG BAROMETER

BENCHMARK STATES 10-YEAR YIELDS

STATE	THIS WEEK	LAST WEEK	CHANGE
California	4.78	4.85	-0.07 bps
Florida	3.98	4.05	-0.07 bps
Illinois	4.32	4.45	-0.13 bps
New York	3.93	3.94	-0.01 bps
Pennsylvania	3.97	3.99	-0.02 bps
Texas	3.90	3.92	-0.02 bps
Virginia	3.55	3.60	-0.05 bps

IN THE PIPELINE

MUNICIPALITY	AMOUNT
PHILADELPHIA HOSPITAL -- $200 MILLION REVS	
MEMPHIS AIRPORT -- $111 MILLION REVS	
PUERTO RICO PUB IMP -- $200 MILLION GOS	
STATE OF NORTH CAROLINA -- $500 MILLION GOS	
STATE OF ILLINOIS -- $3.7 BILLION TAXABLE GO	
BOISE AIRPORT -- $33 MILLION REVS	

BVAL AAA BENCHMARK YIELDS

DESCRIPTION	CURRENT PRICE	CURRENT DATE	PREV PRICE	PREV DATE	NET CHANGE
BVAL 1Y	0.423	02/01	0.450	01/31	-0.027
BVAL 2Y	0.805	02/01	0.827	01/31	-0.022
BVAL 3Y	1.205	02/01	1.191	01/31	0.014
BVAL 4Y	1.550	02/01	1.556	01/31	-0.006
BVAL 5Y	1.907	02/01	1.916	01/31	-0.009
BVAL 6Y	2.266	02/01	2.275	01/31	-0.009
BVAL 7Y	2.618	02/01	2.620	01/31	-0.002
BVAL 8Y	2.897	02/01	2.894	01/31	0.003
BVAL 9Y	3.125	02/01	3.131	01/31	-0.006
BVAL 10Y	3.313	02/01	3.318	01/31	-0.005
BVAL 20Y	4.541	02/01	4.560	01/31	-0.019
BVAL 30Y	4.784	02/01	4.780	01/31	0.004

VOLUME

NEW SUPPLY:	SOLD YTD	TRADED	OFFERINGS
30-DAY $10.7 Bln	$8.2 Bln(Negotiated) $3.7 Bln (Competitive)	$10.8 Bln (MSRB)	$13.6 Bln (Blomberg Pick)

WHAT NOT TO BUY...

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generalizations that astonish anyone who has spent time studying this now most-maligned asset class.

All we have to go on is historical example. How did issuers react in the past to recessions and busts? I know that past performance is no guaranty of future returns, but you have to begin somewhere. If history is a guide, states and municipalities do everything within their power to avoid default and bankruptcy. They don't embrace it, nor do they rush to it lemming-like.

It's okay not to know this history. What's not okay is to ignore it if you are reporting or opining on the subject.

To repeat: municipal bonds aren't part of our culture. There's no television show like Jim Cramer's "Mad Money" about the tax-exempt market. If there were, and I have given this some thought, it would be like that fashion program, "What Not To Wear." Let's call it, "What Not To Buy."

That's because, again using history as a guide, municipal bonds have been a good place to be if you were interested in preservation of capital and tax-free income. The real question before investors wasn't really what to buy, but what to stay away from.

Such as? Well, the last couple of years, it would have been a good idea to avoid unrated, high-yield community district debt used to encourage real estate development in Florida, for example. Of the 79 municipal bonds that defaulted in 2010, 36 were sold by such districts, 27 of them in Florida, according to the Distressed Debt Securities Newsletter.

It's not just Florida. Unrated, high-yield bonds that depend upon real estate booms have proven unwise investments in California, and Colorado and Texas. Leave those to the professionals. The same goes for bonds used to finance things like for-profit jails, weird theme parks, dumb tourist attractions, museums without endowments, mills that are supposed to turn stuff into energy — you get the idea.

They will all soon be topics for discussion on "What Not To Buy."

TAX-EXEMPTS EXTEND...

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Yields on 30-year top-rated debt were 113 percent of 30-year Treasuries on Jan. 14, Bloomberg data show. The ratio fell to 105.5 percent on Jan. 31 as muni prices outperformed. Prices move inversely to yields.

"Certainly, the improvement in market pricing should be a net positive for bond fund flows, at the very least pulling flows down from the all-time record levels seen for the week ending Jan. 19," Citigroup said.

Investors pulled about $1.9 billion from U.S. municipal-bond funds in the week ended Jan. 26, the 11th straight week of outflows, according to Lipper U.S. Fund Flows. About $4 billion was extracted the previous week, the most since Lipper started compiling the data in 1992. Withdrawals have totaled $22.5 billion since the week ended Nov. 17, according to Lipper, a Denver-based research company.

The Transitional Finance Authority sold $203 million in 24-year tax-exempt bonds to individual investors yesterday at a yield of 5.15 percent, according to data compiled by Bloomberg. Institutional investors, such as mutual funds, will place orders for debt today. The offering includes $100 million in taxable bonds.

Ray Orlando, a spokesman for the city's **Office of Management and Budget**, didn't immediately respond to telephone and e-mail requests for comment.

The issue, backed by personal-income tax revenue, carries top rankings from **Fitch Ratings** and **Standard & Poor's**, and is rated Aa1 by **Moody's Investors Service**, second-highest.

The authority issued $875 million in tax-exempts Jan. 13, with bonds due in November 2039 priced to yield 5.33 percent, or 36 basis points below top-rated 29-year debt, according to a Bloomberg Valuation index. The securities traded Jan. 31 at a so-called spread of 33 basis points to the index.

A taxable corporate bond from top-rated **Microsoft Corp.** due in June 2039 was yielding 5.1 percent on Jan. 28, according to Trace, the bond-price reporting system of the Financial Industry Regulatory Authority. For an investor in the top tax bracket, that equates to a 3.32 percent tax-free yield.

While market sentiment has turned positive, demand would need to increase along with supply for the rally to continue, according to Klein.

"When regular issuance returns to the market, and if demand doesn't keep up, yields might start to go up," he said.

Issuers plan to sell $3.3 billion in municipal debt this week, Bloomberg data show. Illinois has a $3.7 billion taxable issue set to sell later this month.

California Treasurer **Bill Lockyer** said investment banks included $1.5 million in dues to trade groups in their calculation of fees paid out of bond proceeds since 2005. He ordered them to stop the practice, and refund the money to the state.

Following are descriptions of pending sales of U.S. municipal debt:

NORTH CAROLINA, the 10th most-populous U.S. state, plans to sell $500 million in tax-exempt, limited-obligation debt through competitive bidding today to finance capital improvements. The bonds, backed by state appropriations, are rated Aa1 by Moody's, one level below the state's general-obligation rating.

SAN JOAQUIN COUNTY TRANSPORTATION AUTHORITY, created in 1990 to collect and oversee a half-cent sales tax dedicated to transportation projects, plans to sell $212 million in tax-exempt debt today. The securities are rated AA by S&P, third-highest, and Aa3 by Moody's, fourth highest. **JPMorgan Chase & Co.** will market the Californian county's debt.

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DIARY

■ Citigroup's **George Friedlander** finds "the tendency of some relatively new observers of the muni market to use the recent market weakness and investor nervousness as the starting point for scare stories that have little or no analytical content but seem `logical' during a period of market weakness and budgetary pressures." Writing in the firm's Municipal Market Comment, Friedlander continues, "We continue to receive more inquiries from relatively sophisticated investors than we ever have before in our 35+ years covering the muni market as to what the likelihood is that Issuer X will miss a debt service payment. Quite simply, investors are quite nervous, and it appears observers who might benefit in one way or another by feeding those fears are out in force, food in hand." Quite.

■ To counter such Inexpert Testimony, **Robert Doty**, a financial adviser to state and local issuers and lawyer in Sacramento, California, is writing "The Municipal Bond Investor's Little Handbook," which he intends to subtitle "How to Tune-Out Media Hype and Make Intelligent Bond Investments." Doty's friends appreciate the "little" in the title. His previous work, "From Turmoil to Tomorrow: The Emerging New World of Public Finance" was a 2,500-page, five-volume production.

■ The Securities and Exchange Commission asks Harrisburg, Pennsylvania, for information on its disclosures to investors after the city's debts threatened to push it into bankruptcy. Harrisburg in December was declared "financially distressed" under Pennsylvania's Act 47 oversight program for cash-strapped cities. The city sought state assistance because it depleted budget reserves to make payments on $282 million in debt it guaranteed for an incinerator operated by the independent Harrisburg Authority. Its brush with bankruptcy stoked speculation among investors about potential defaults by other cities. The SEC doesn't regulate municipalities; it does have the power to pursue officials who file fraudulent or misleading documents to investors. Four former San Diego officials in October agreed to pay $80,000 to settle an SEC fraud suit that accused them of failing to disclose the size of pension-fund shortfalls when the city sold bonds. And in August, New Jersey agreed to settle claims it didn't tell investors that it failed to put enough cash into its two biggest pension plans when it sold $26 billion of bonds from 2001 to 2007. The SEC is also investigating statements by Illinois about potential savings from changes to its pension system, which has assets covering less than half of its promised benefits.

■ State tax collections rise 6.9 percent for the last quarter of 2010 from the same period a year earlier, the Nelson A. Rockefeller Institute of Government reports, citing preliminary data from 41 states. It would mark the fourth-straight increase and the biggest since April-June 2006, when states were benefiting from the real-estate boom, according to the Albany, New York-based group. "While state tax collections are gradually stabilizing, they have yet to make up for the deep losses brought by the Great Recession," write **Lucy Dadayan** and **Donald Boyd** of the institute.

■ The Municipal Securities Rulemaking Board, the Alexandria Virginia-based self-regulatory organization that crafts rules for the $2.9 trillion state and local government-bond market, seeks comment on a draft interpretive notice on the application of Rule G-17 to underwriters of municipal securities. G-17, which concerns "fair dealing," would require underwriters to disclose material terms, risks, incentives and conflicts of interest. Underwriters should make the reason for a deal clear "so that an issuer or an investor knows what those motives are," says **Michael Bartolotta**, chairman of the MSRB, and also vice chairman of Dallas-based First Southwest Co.

■ Municipalities sell $11.9 billion in fixed-rate debt in January, the smallest amount since at least February 2003. About $31.9 billion was sold last January. The reduced supply has helped drive up demand and push down yields, says **Duane McAllister**, who helps oversee $1.7 billion in assets at M&I Investment Management in Milwaukee. Yields on top-rated tax-exempts have fallen about 16 basis points, or 0.16 percentage point, since Jan. 18. But the muni market will continue to underperform "until we get some more supply and until the fund redemptions are behind us," says McAllister. "They've slowed, but I'm still cautious. It feels like we're not quite out of the woods yet."

■ Fewer bonds sell; fewer trade. Investors in January trade an average of $12.7 billion worth of municipal bonds daily, about 7 percent lower than last January, as new issues dwindle with the end of Build America Bonds and demand cools on speculation about state and local defaults. January's volume was down from $13.6 billion in the same period last year, according to MSRB data. Investors traded about $12.8 billion a day in 2010.

■ California Governor **Jerry Brown** says the state's residents should be given the chance to decide whether to extend tax increases to limit budget cuts, calling Republican opposition to a vote "unconscionable." Brown wants lawmakers to call a special election in June to allow voters to choose whether to extend higher vehicle fees and sales and income taxes to help balance a projected deficit that's equal to 20 percent of the state's general fund budget in the coming fiscal year. Brown, governor from 1975 to 1983, has vowed to fix the financial troubles that have left California with the biggest deficit of all U.S. states, and the lowest credit rating (A1 from Moody's, A- from Standard & Poor's).

RESULTS OF SALES

Long Term Bond Sales Results

SELLING DATE	ISSUER	STATE	RATING*	TAX	AMT (MM)	1 YEAR	5 YEAR	10 YEAR	20 YEAR	STATUS	TYPE	SR MGR
01/31	Nyc Trans Fin Auth D-1	NY	Aa1/AAA/AAAe	N	775.00		5.000/2.150	5.000/3.710	5.000/100.000	Retail	Negt	Goldman Sachs & Company
01/31	Minnesota Univ Regnts -A	MN	Aa1/AA/A+e	N	335.82	4.000/0.750	5.000/2.280	5.000/3.620	5.250/4.770	Repriced	Negt	Barclays Capital Inc
01/31	Lucas Cnty Hosp Rev -A	OH	Aa3e/AA-e/	N	182.16		3.125/3.250	5.000/4.870	5.750/5.980	Repriced	Negt	Barclays Capital Inc
01/31	Douglas Cnty Sls Tax	GA	Aa2e/AA-/A+e	N	97.25	5.000/0.700	5.000/2.290			Final	Negt	Citigroup Global Mkts Inc
01/31	Allegheny Hgr Edu Bldg -A	PA	A2/A-/AAAe	N	53.51		3.000/2.850	5.000/4.610	5.500/5.650	Repriced	Negt	Wells Fargo Bank N.A.
01/31	Minnesota Hsg Fin Auth	MN	Aa2/AA+/A+e	N	21.75	2.000/0.850	4.000/2.510	3.875/3.950	5.000/5.070	Final	Negt	Rbc Capital Markets
01/31	San Luis Fac Dev Corp	AZ	A3e/AA+e/BBB+e	N	20.17		6.750/6.750	7.500/7.500		Final	Negt	Herbert J. Sims & Co Inc
01/31	Maryland Env Svc Rev	MD	Aa2/AA/A+e	N	18.90	3.000/1.000	4.000/2.680	5.000/4.100		Repriced	Negt	Morgan Keegan & Co Inc
01/31	Lenawee Cnty Hosp Fing -B	MI	Aa3e/AA-e/	N	17.30		3.250/3.380			Repriced	Negt	Barclays Capital Inc
01/31	Escambia Co Hsg Fin Auth	FL	Aa3e/AA+e/A+e	N	16.53		3.000/NRO	4.625/NRO	5.750/5.910	Final	Negt	Rbc Capital Markets
02/01 11:00	Lakeland Csd	NY	Aa2/AA-/A+e	N	22.56	3.000/NRO	5.000/NRO			Awarded	Comp	Td Securities (Usa) Llc
02/01 11:00	Mckinney Econ Dev Corp	TX	Aa2/AA-/A+e	N	6.86	2.500/NRO	3.000/NRO	4.000/NRO		Awarded	Comp	Jp Morgan Securities Inc
02/01 11:00	Orleans Town	MA	Aa3e/AA+/A+e	Q	6.80	3.000/0.600	2.500/1.900	3.300/3.350	4.375/4.400	Awarded	Comp	Robert W. Baird & Co Inc
02/01 11:00	Bangor -Ref	ME	Aa2/AA-/A+e	Q	6.39	2.000/NRO	2.000/NRO	3.250/NRO		Awarded	Comp	Ubs Financial Services

*Ratings from Moody's/S&P/Fitch respectively