

An Underwriter's View of the World

What Issuers Need to Know

Minnesota Government Finance Officers Association
November 17, 2010



Member FINRA and SIPC

The information in this presentation is based on sources believed to be reliable, but does not purport to be complete and is not warranted by Northland Securities, Inc. (ASL #1150)



Presenters

◦

- Rusty Fifield
- Paul Donna

Premise

- Significant changes in marketplace for municipal bonds
- Issuers need to understand how underwriters work
- Both are critical to planning and issuing debt

Presentation

- Part 1 – Changes in the bond world and how it affects you
- Part 2 – A look inside the “black box” – the competitive and negotiated sale of bonds
- Part 3 – Your questions

Part I – The Times are Changin’

- Significant changes in market place for municipal bonds over the past two years
- Rules of the game are different
- Essential for issuers to understand changes and the effects

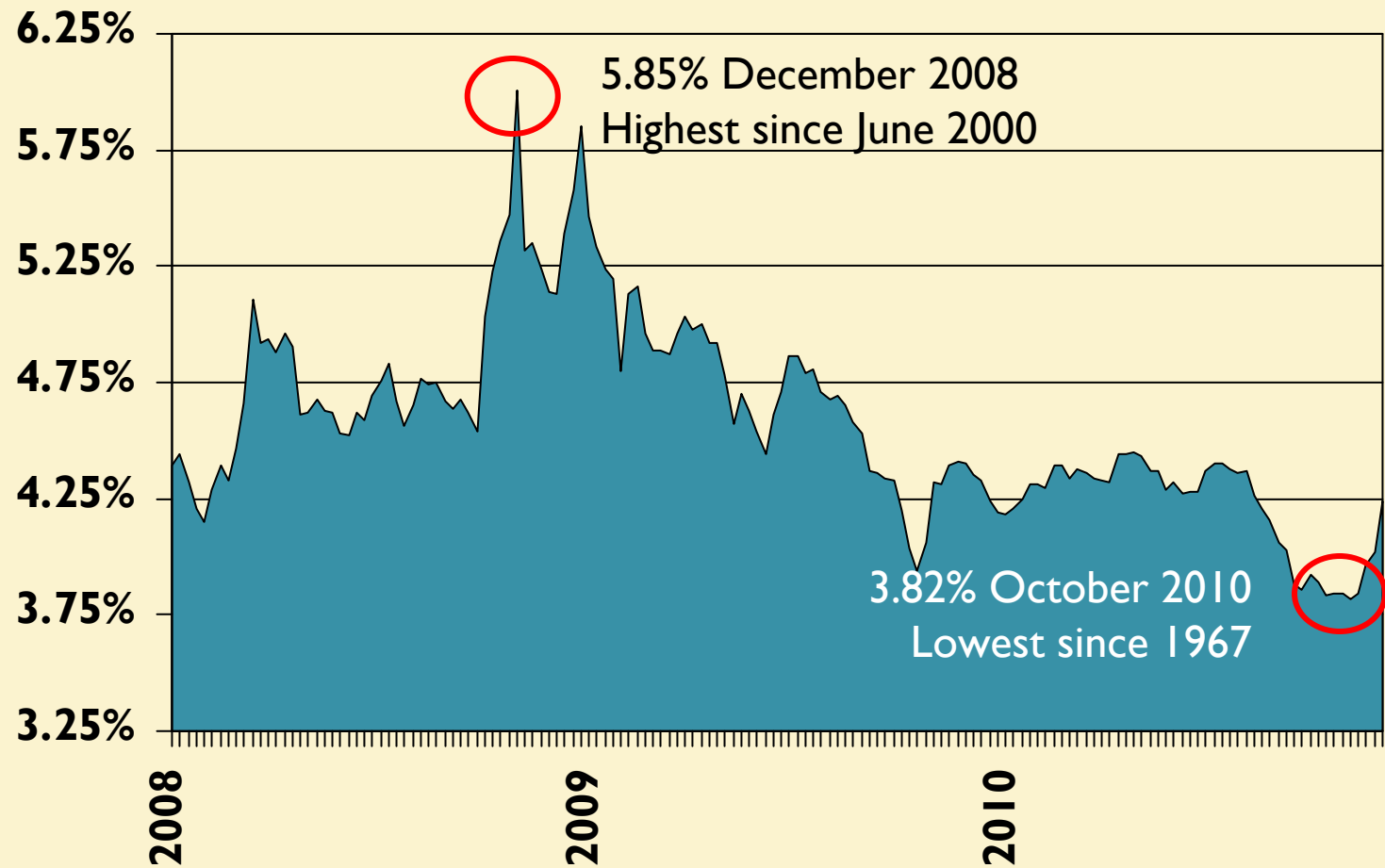
Key Changes

- Worst recession since Great Depression
- Ratings recalibration
- ARRA (American Recovery and Reinvestment Act)

Interest Rates

- Peak
- Fall
- Windows

BBI – 20 Year GO Index

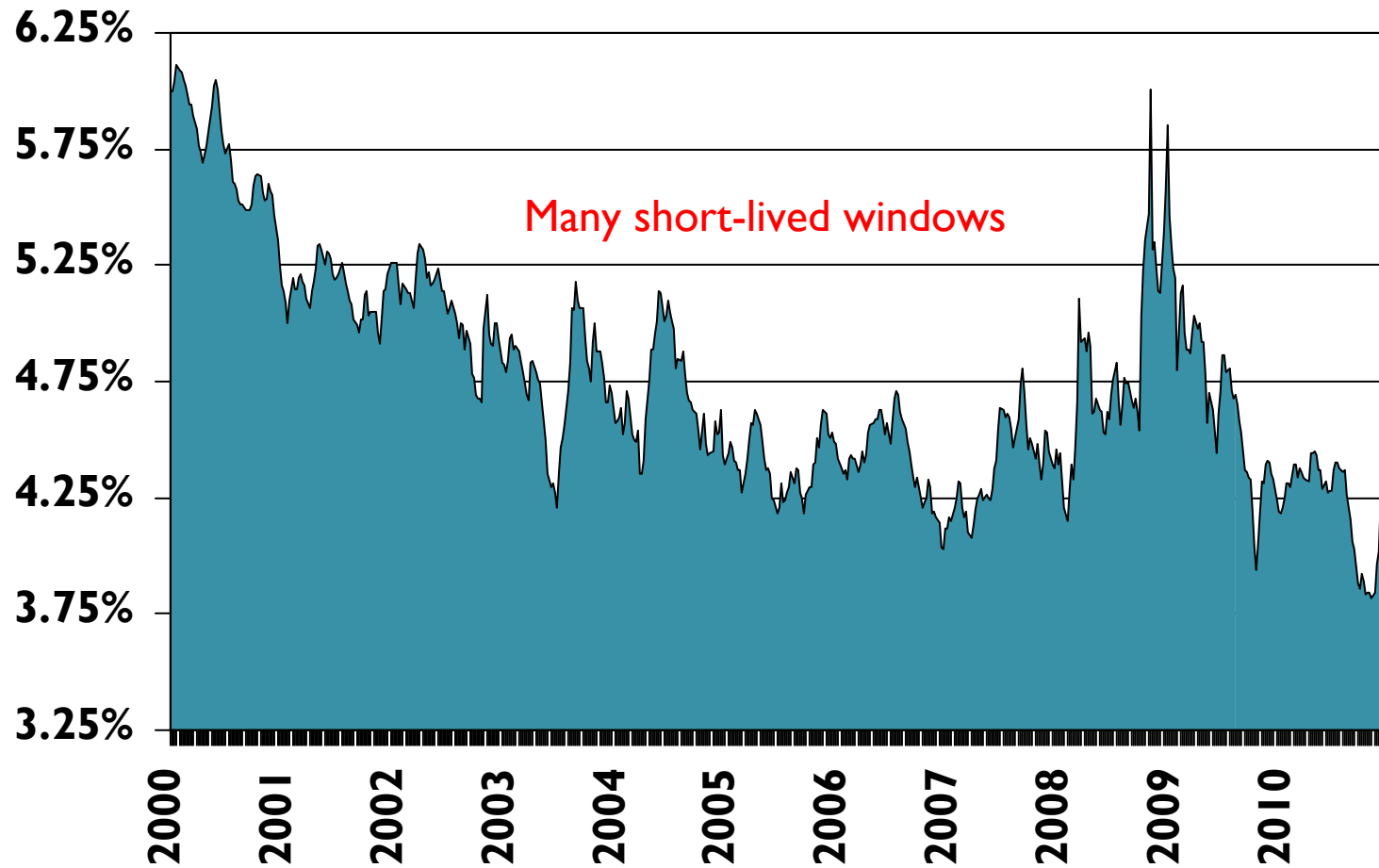


Source: Bond Buyer's 20-Year G.O. Index

Interest Rates

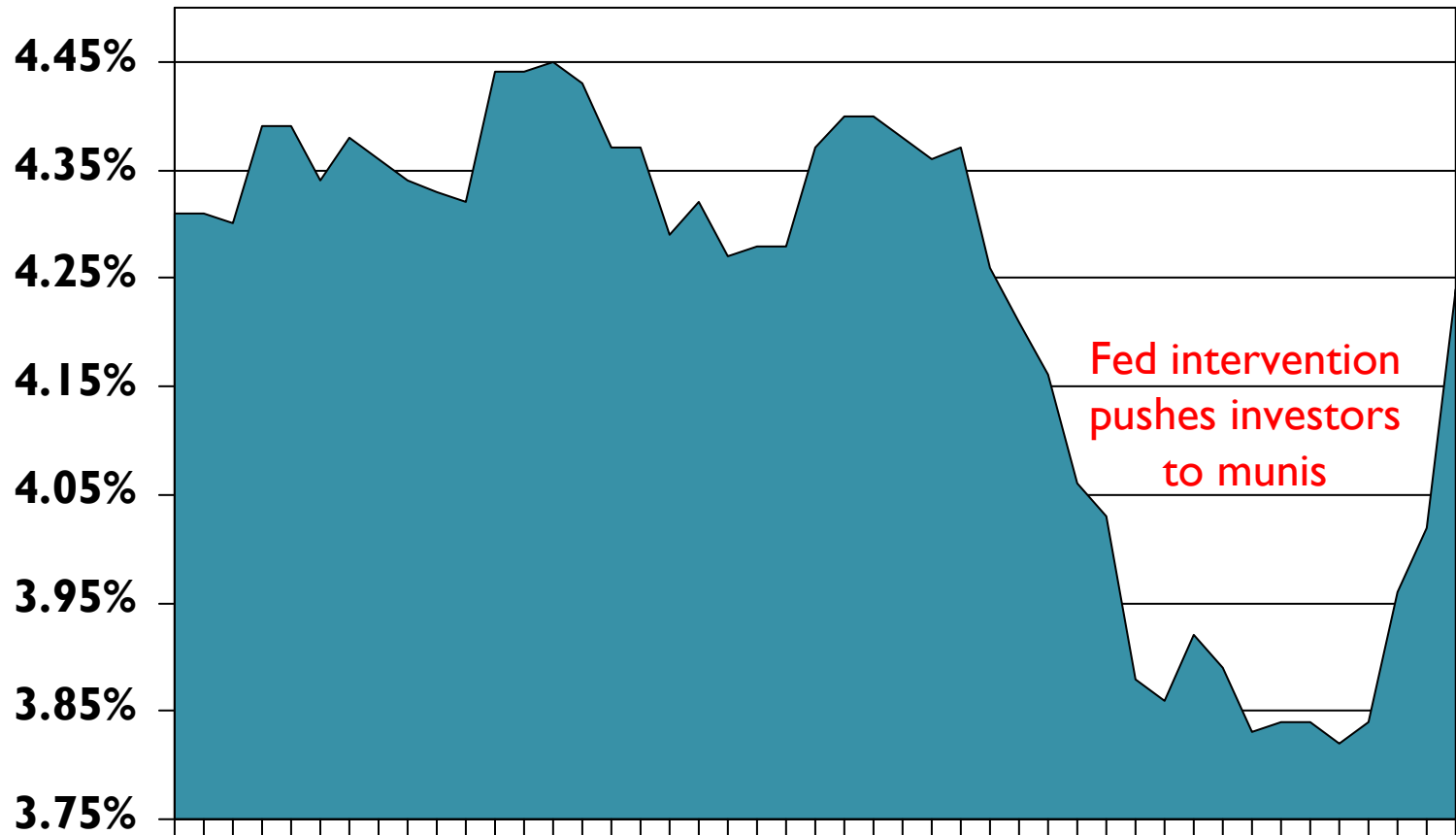
- Muni rates followed overall downward rate trend
- Roller coaster continues
- Expect general upward movement in rates next 6-12 months

BBI Since 2000



Source: Bond Buyer's 20-Year G.O. Index

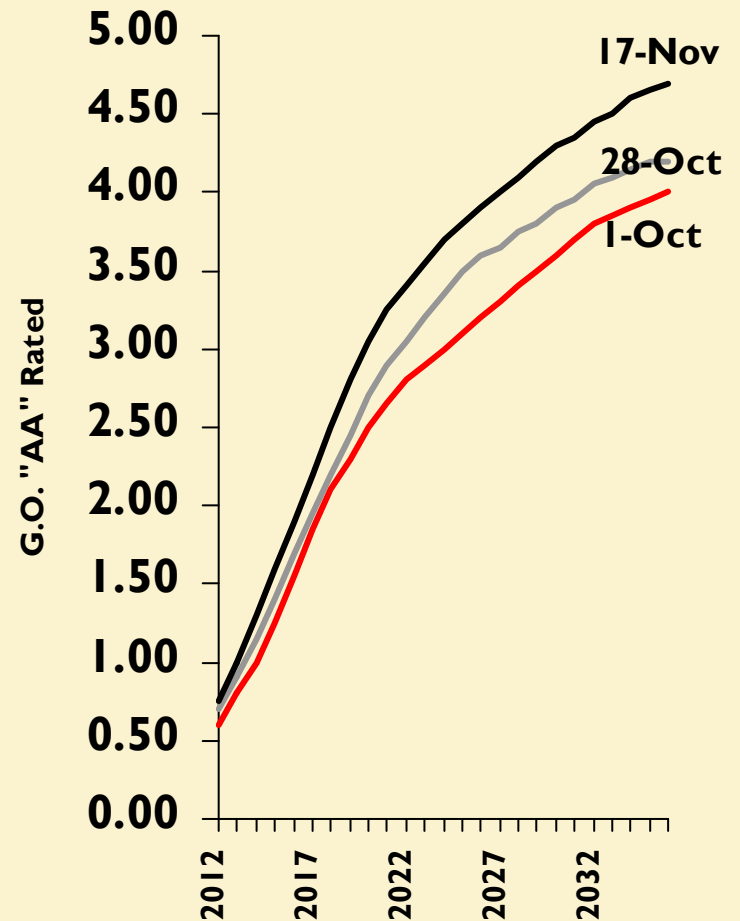
BBI - 2010



Source: Bond Buyer's 20-Year G.O. Index

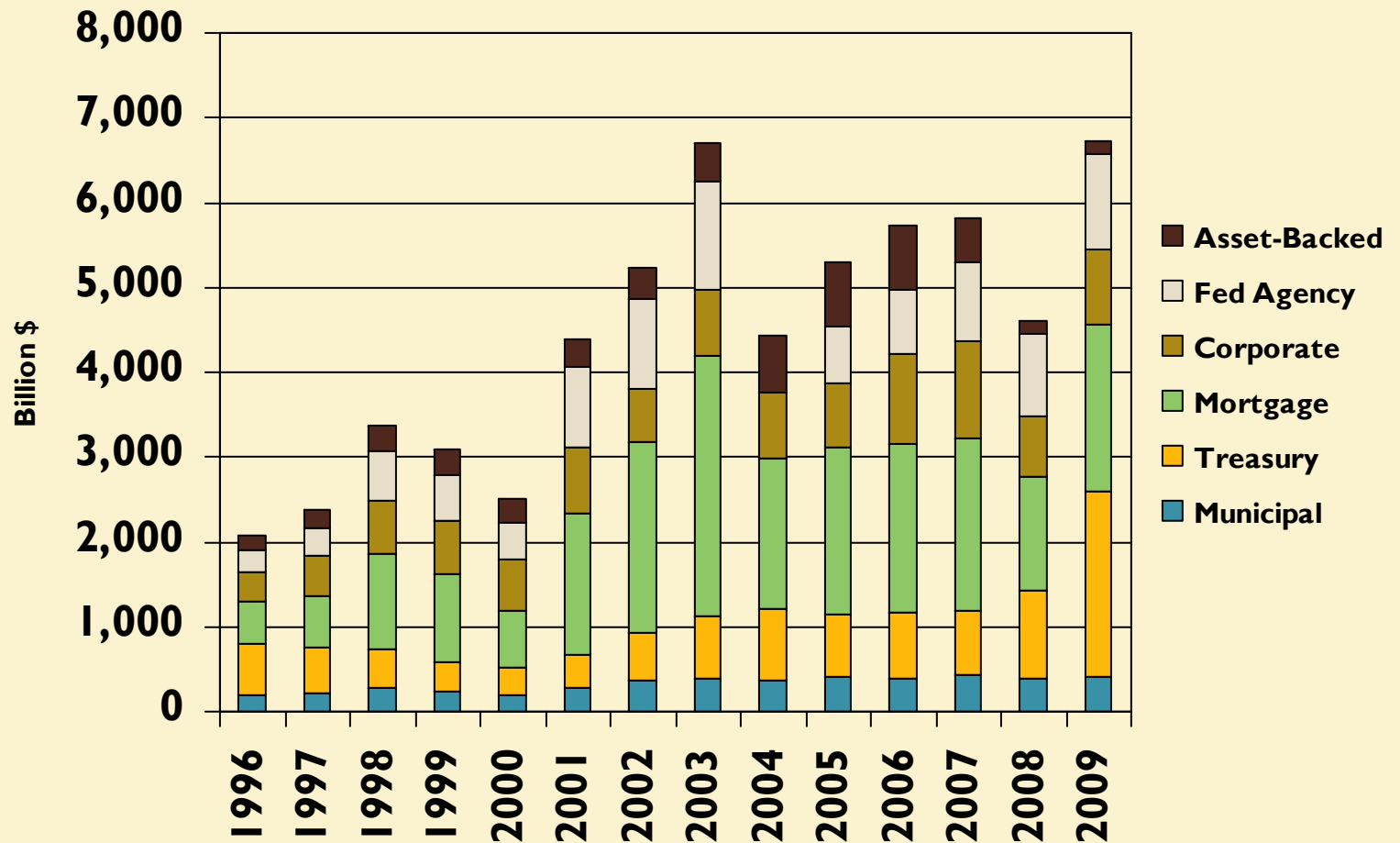
Interest Rates

- Steep yield curve
- Greater investor willingness to accept very low rates for shorter maturities
- Jump in past 6 weeks
 - 15 bp in 2012
 - 70 bp in 2036



Source: Northland Securities

Issuance in U.S. Bond Markets



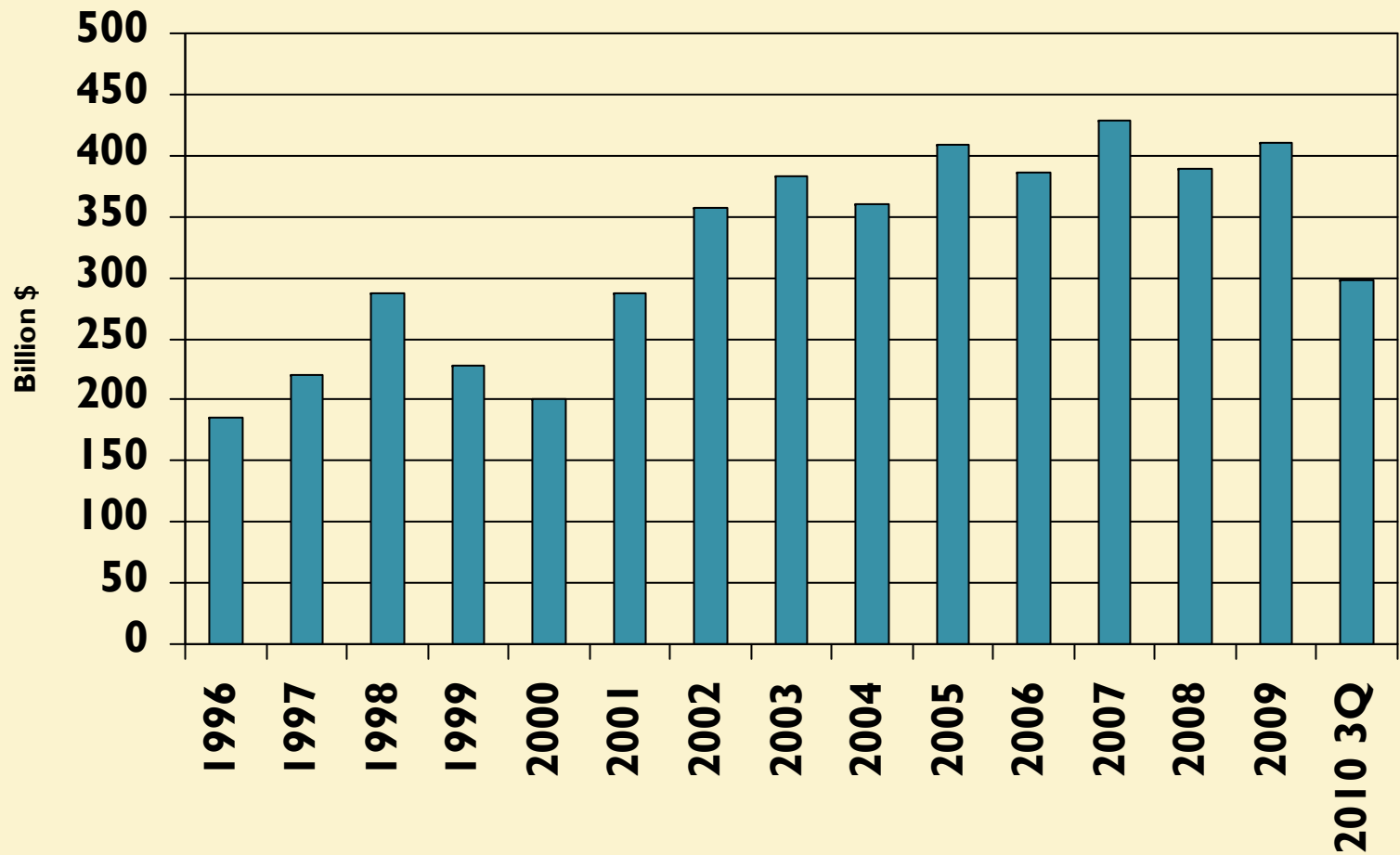
Source: SIFMA (U.S. Department of Treasury, Federal Agencies, Thomson Reuters)

Bond Market

- Munis
 - 9.28% of total bonds in 1997
 - 6.10% on 2009
 - 2009 total volume 2nd highest
- Large increase in Treasuries
 - \$752B in 2007
 - **\$2,185B** in 2009
- Increased competition for investors

Source: SIFMA (U.S. Department of Treasury, Federal Agencies, Thomson Reuters)

Issuance in U.S. Bond Markets Municipals

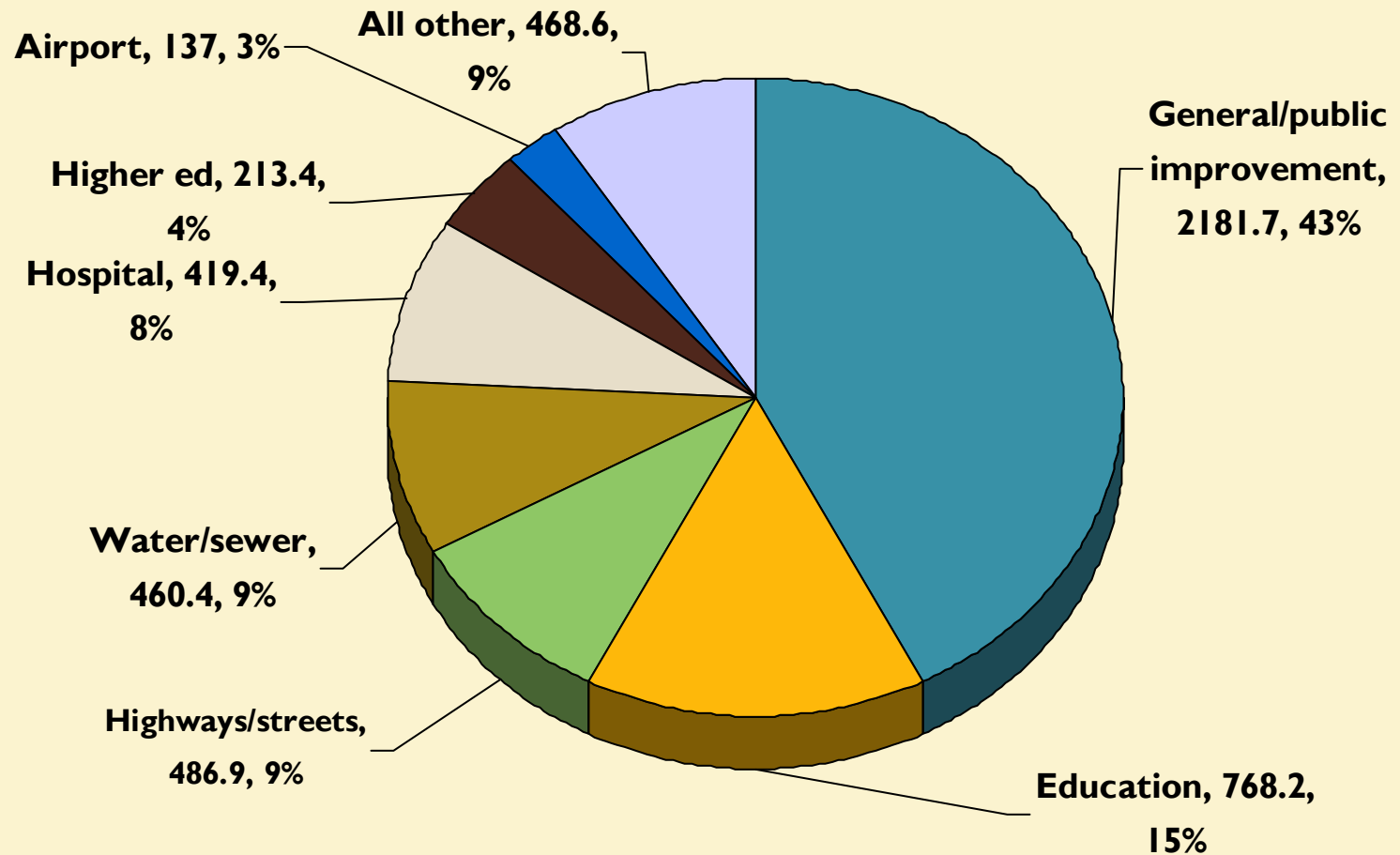


Source: SIFMA (U.S. Department of Treasury, Federal Agencies, Thomson Reuters)

Municipals

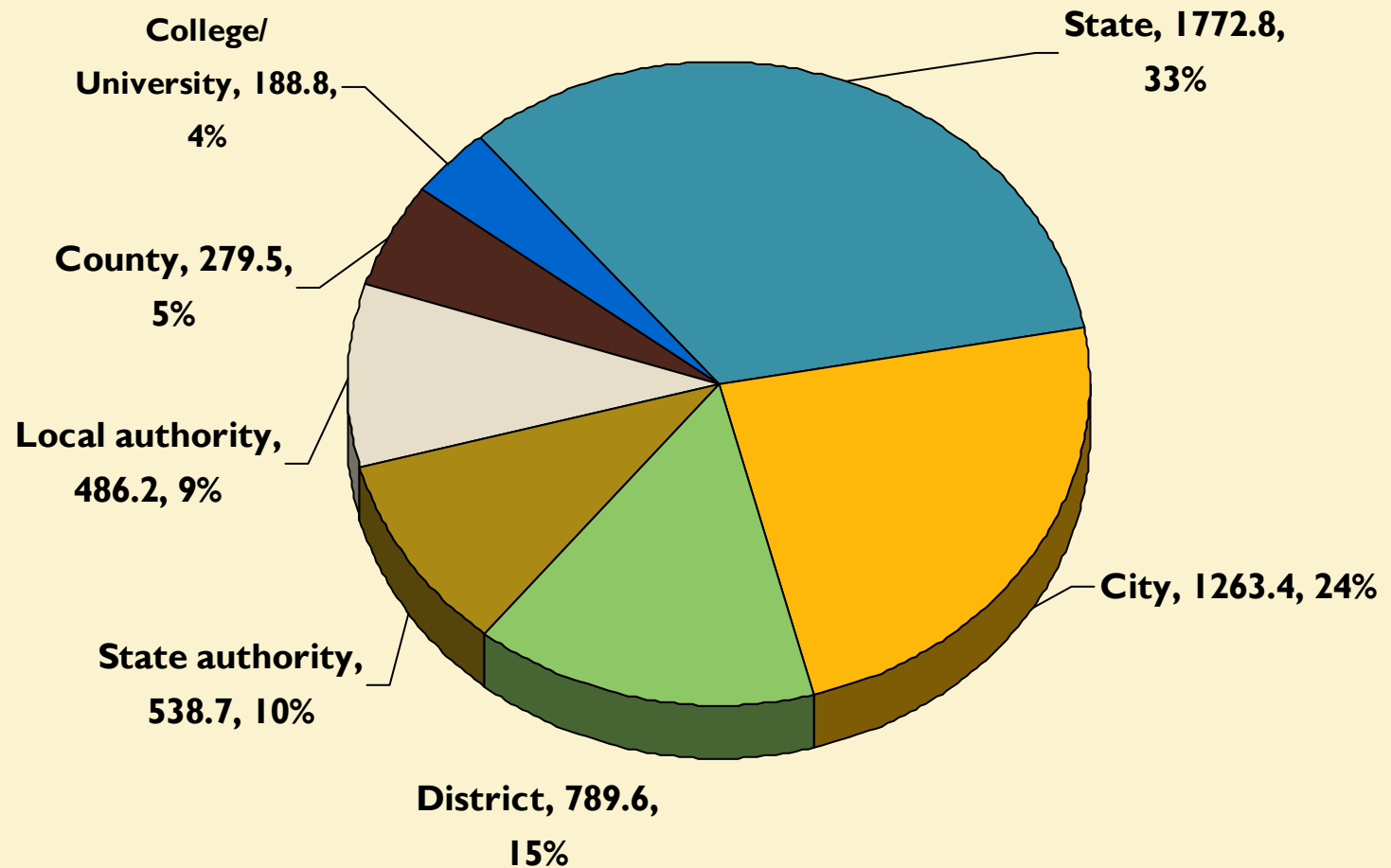
- 2009 total volume 2nd highest
- 2010 may surpass
 - Low rates cause refunding
 - Large volume expected in 4th quarter
 - Year end push of BABs and ARRA bonds

Minnesota New Long Term 2010 – 3 Quarters (Million \$)



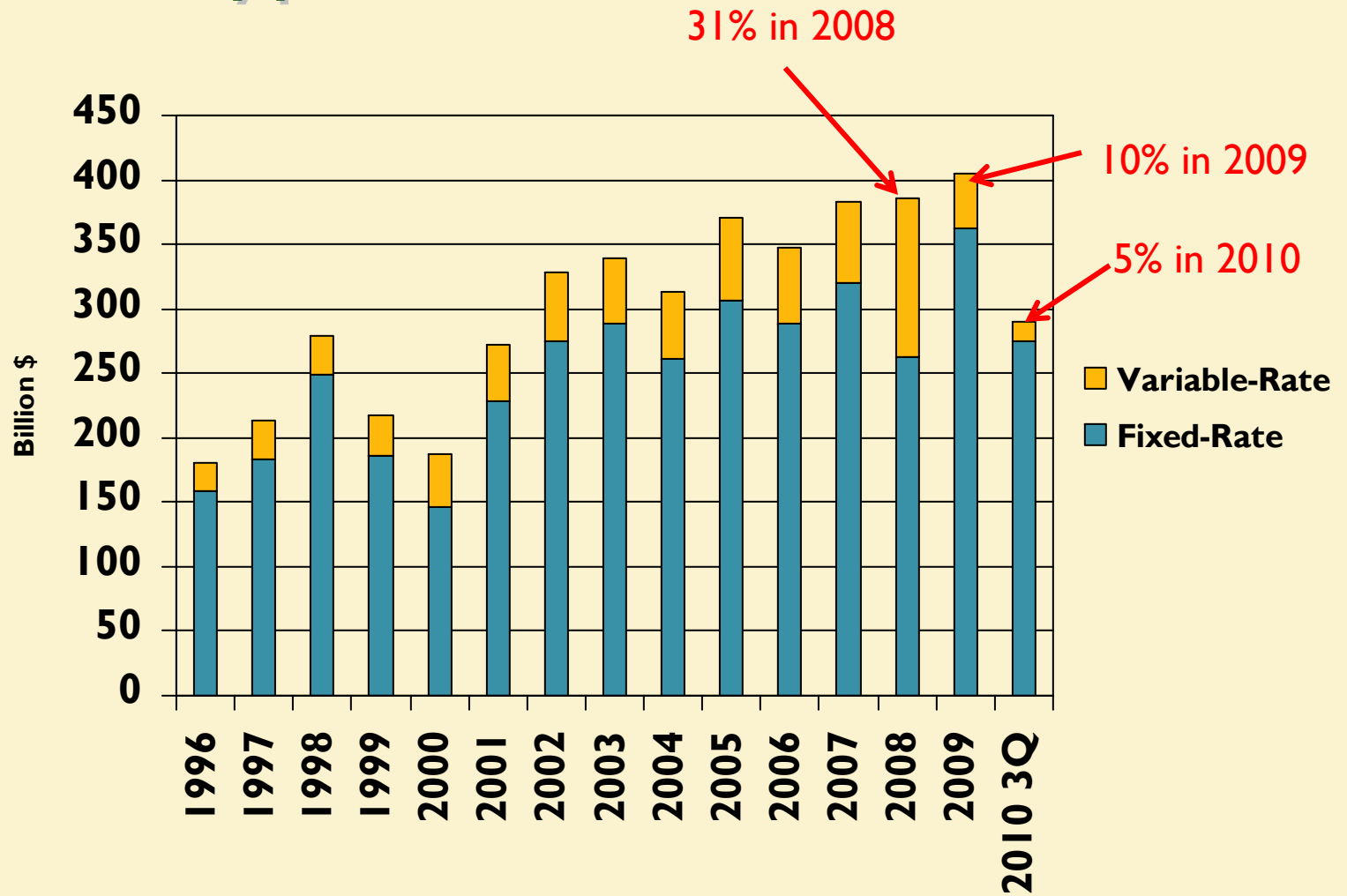
Source: Thomson Reuters

Minnesota New Long Term 2010 – 3 Quarters (Million \$)



Source: Thomson Reuters

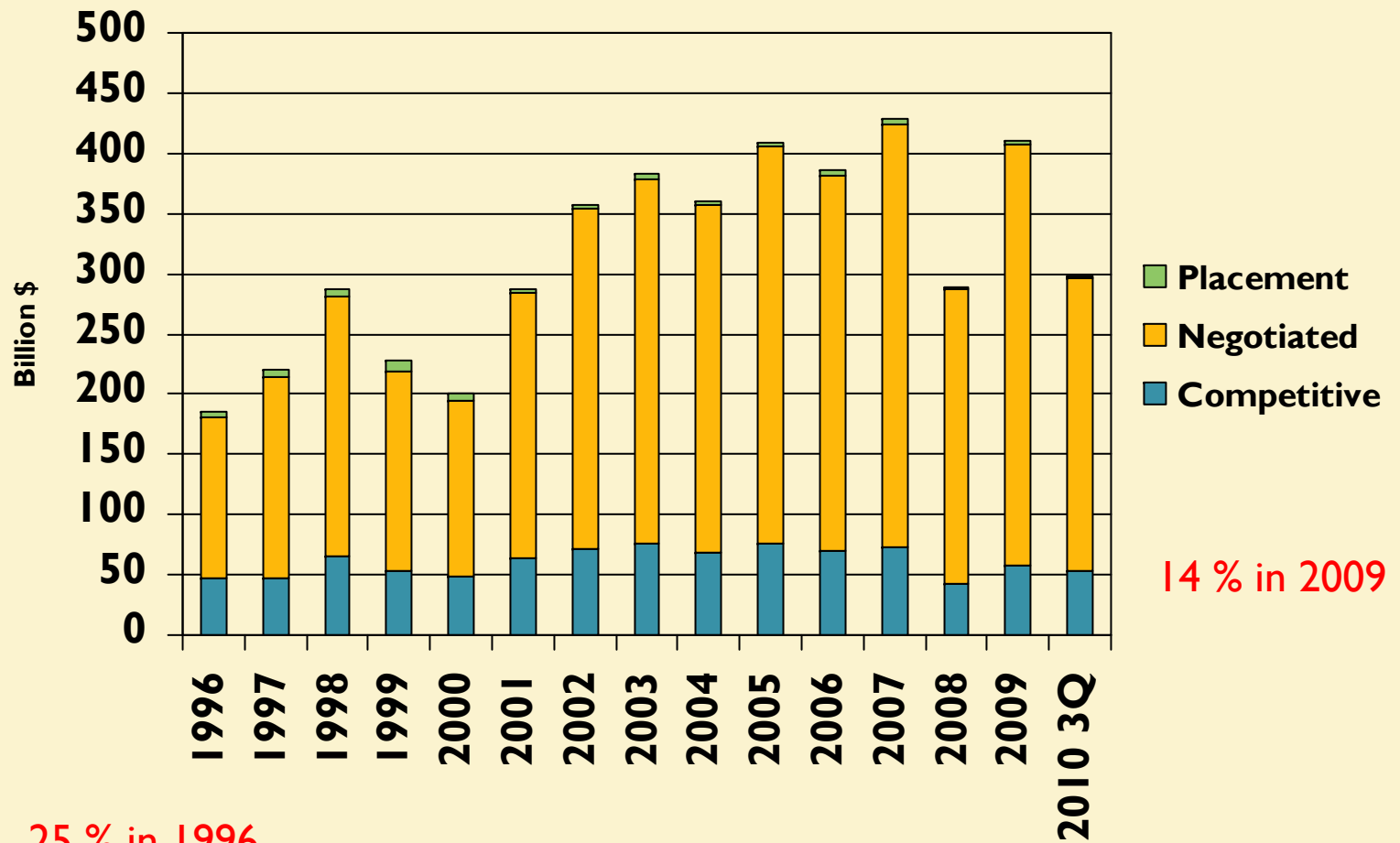
Municipal Bond Issuance Rate Type



Source: SIFMA (Thomson Reuters)

Municipal Bond Issuance Type of Sale

20% Competitive 1996-2009

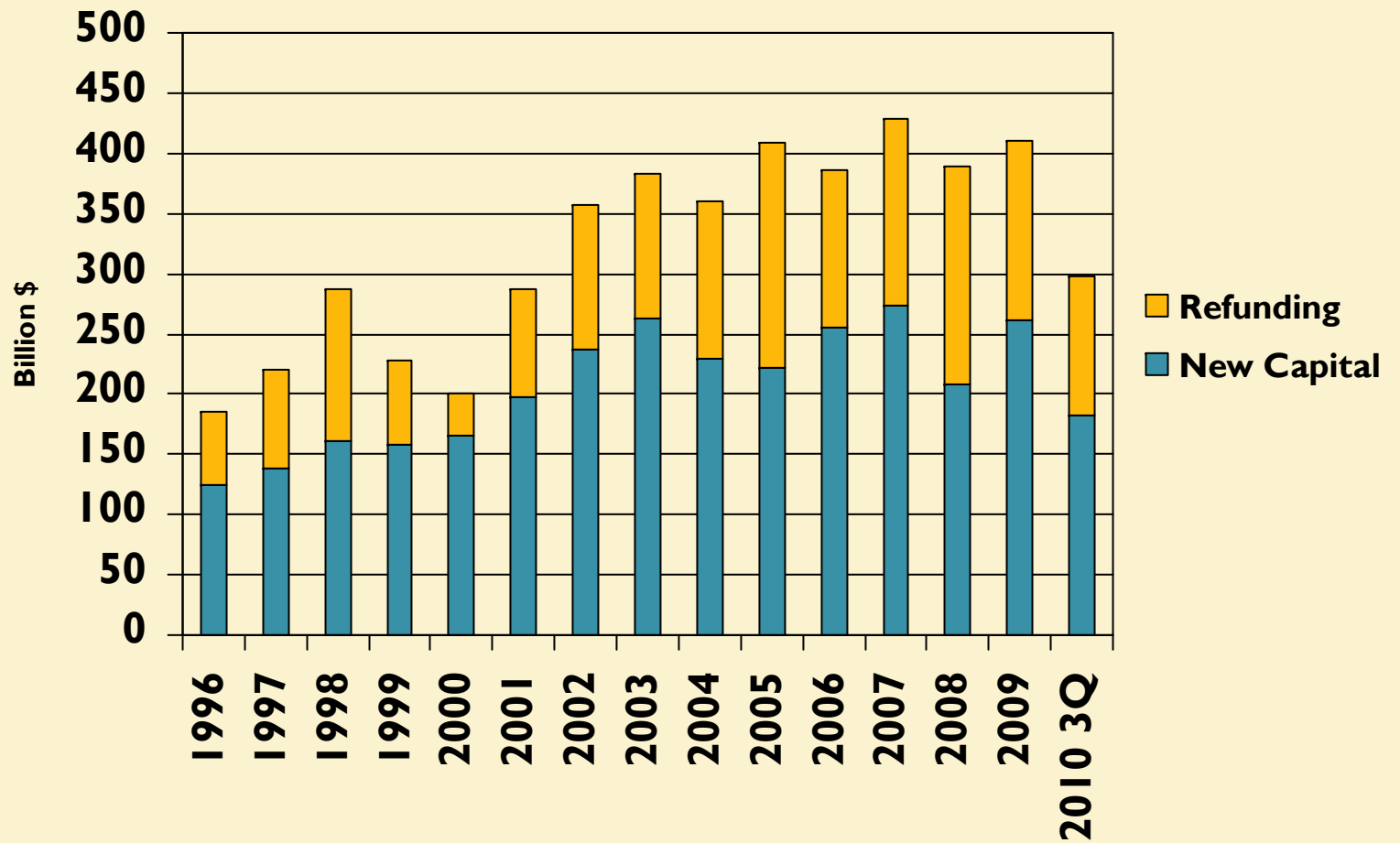


25 % in 1996

14 % in 2009

Source: SIFMA (Thomson Reuters)

Municipal Bond Issuance Purpose

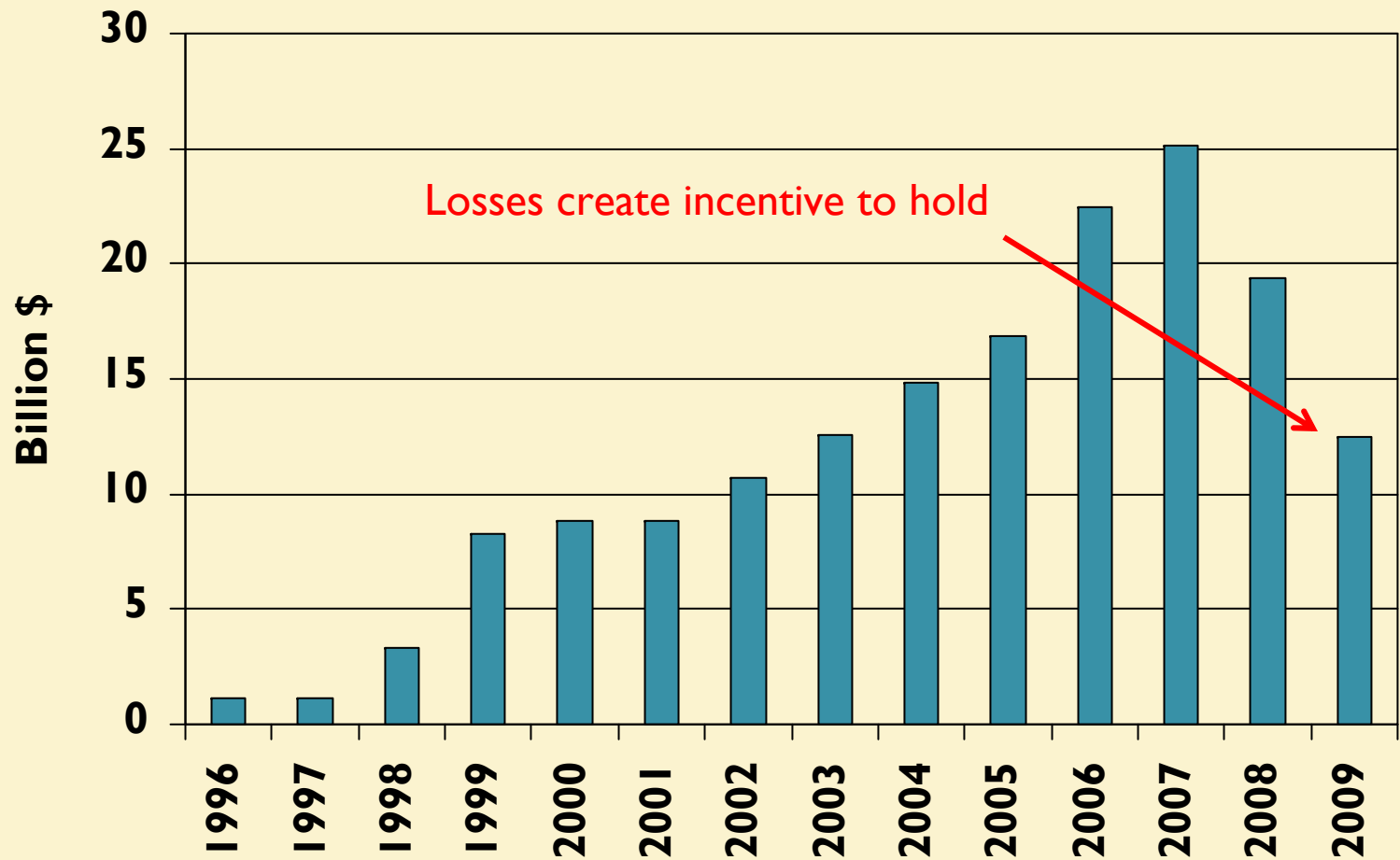


Source: SIFMA (Thomson Reuters)

Refunding

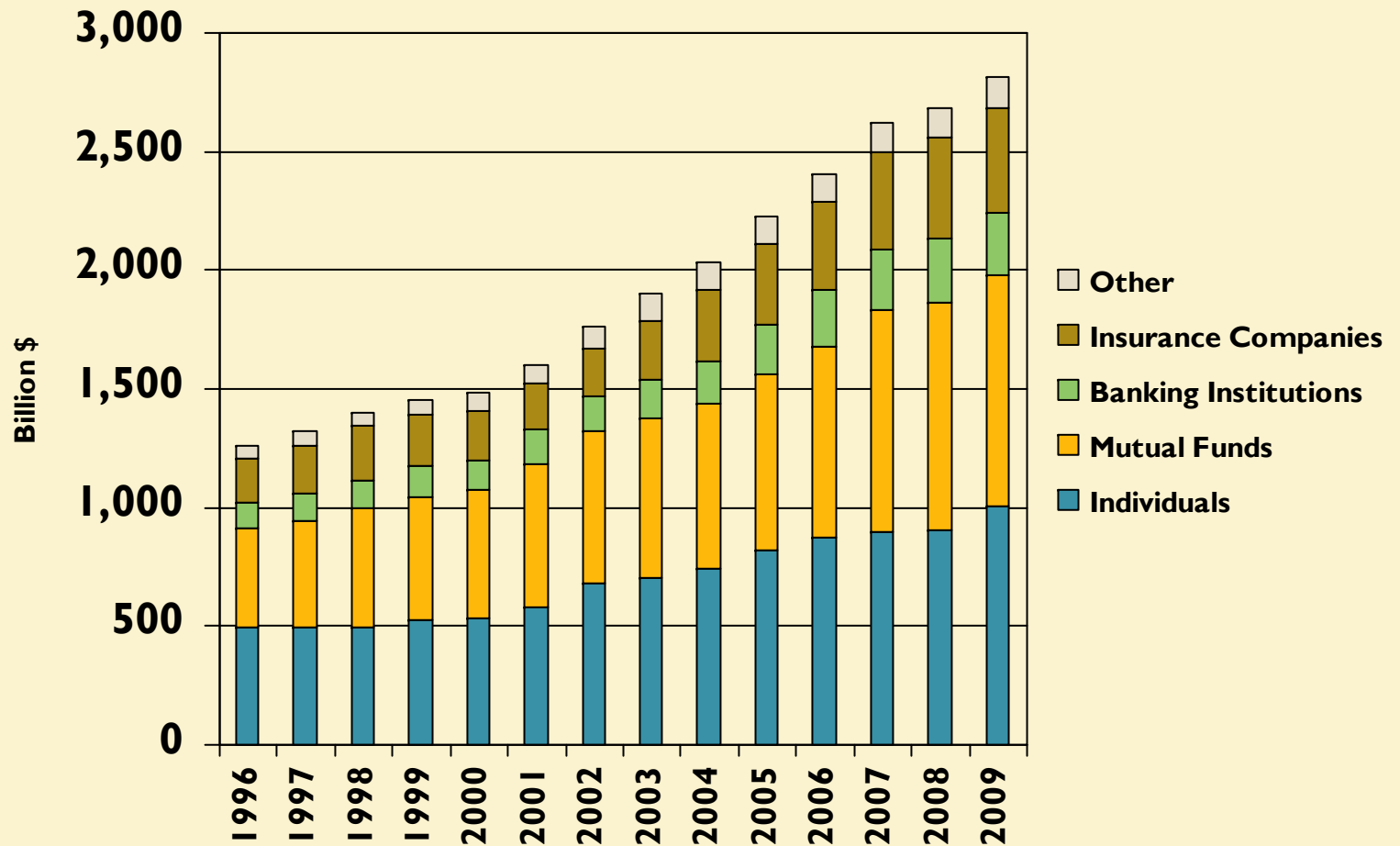
- Over 30% total volume since 2001
- Peak at 46% in 2008
 - Lowest volume of New Capital since 2001
- 38% 2010 year to date
- Incentives for new projects
 - Low rates
 - Low construction costs

Average Daily Trading Volume Municipals



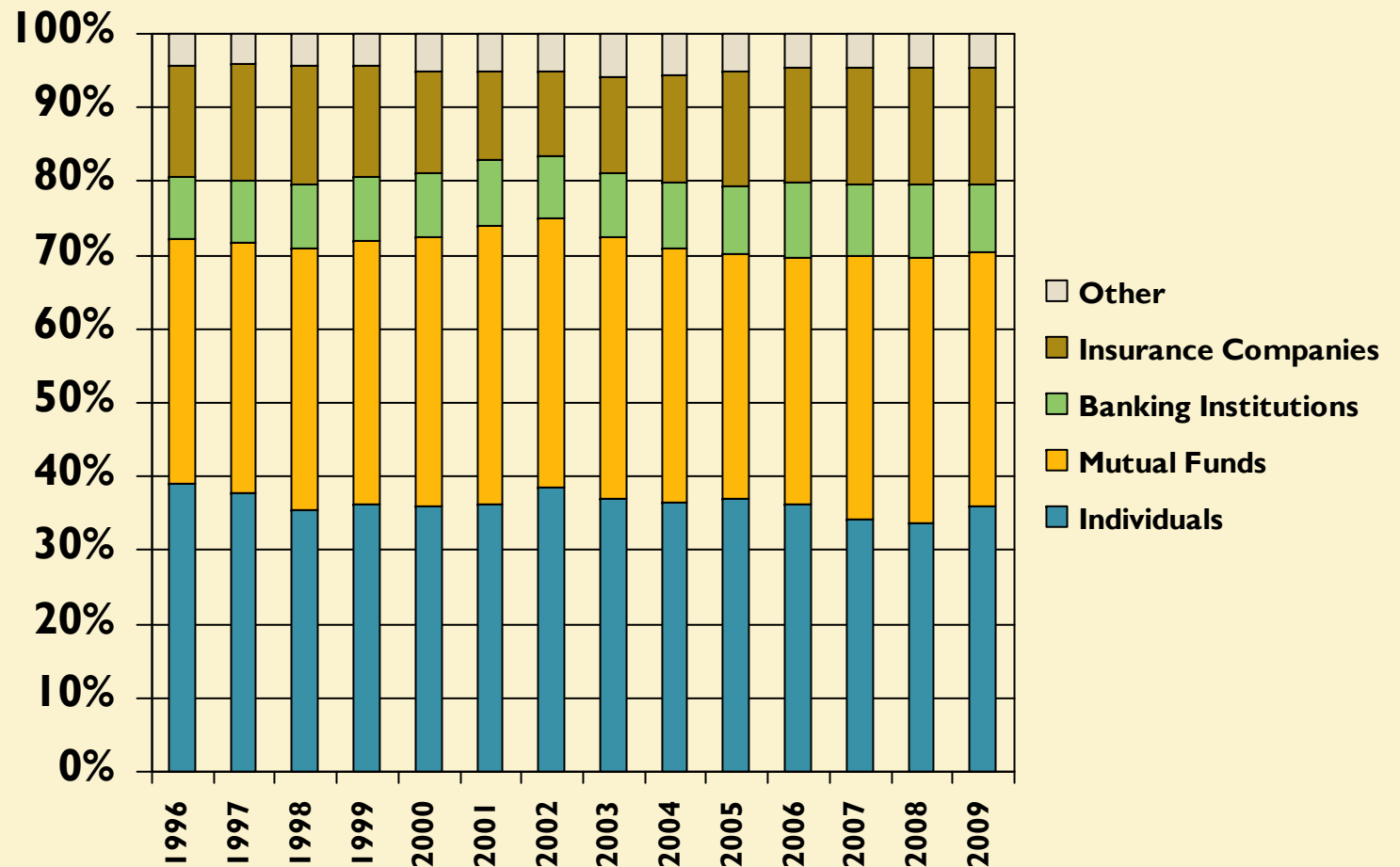
Source: SIFMA (Federal Reserve Bank of New York, MSRB, FINRA)

Holders of Municipal Securities



Source: SIFMA (Federal Reserve System)

Holders of Municipal Securities



Source: SIFMA (Federal Reserve System)

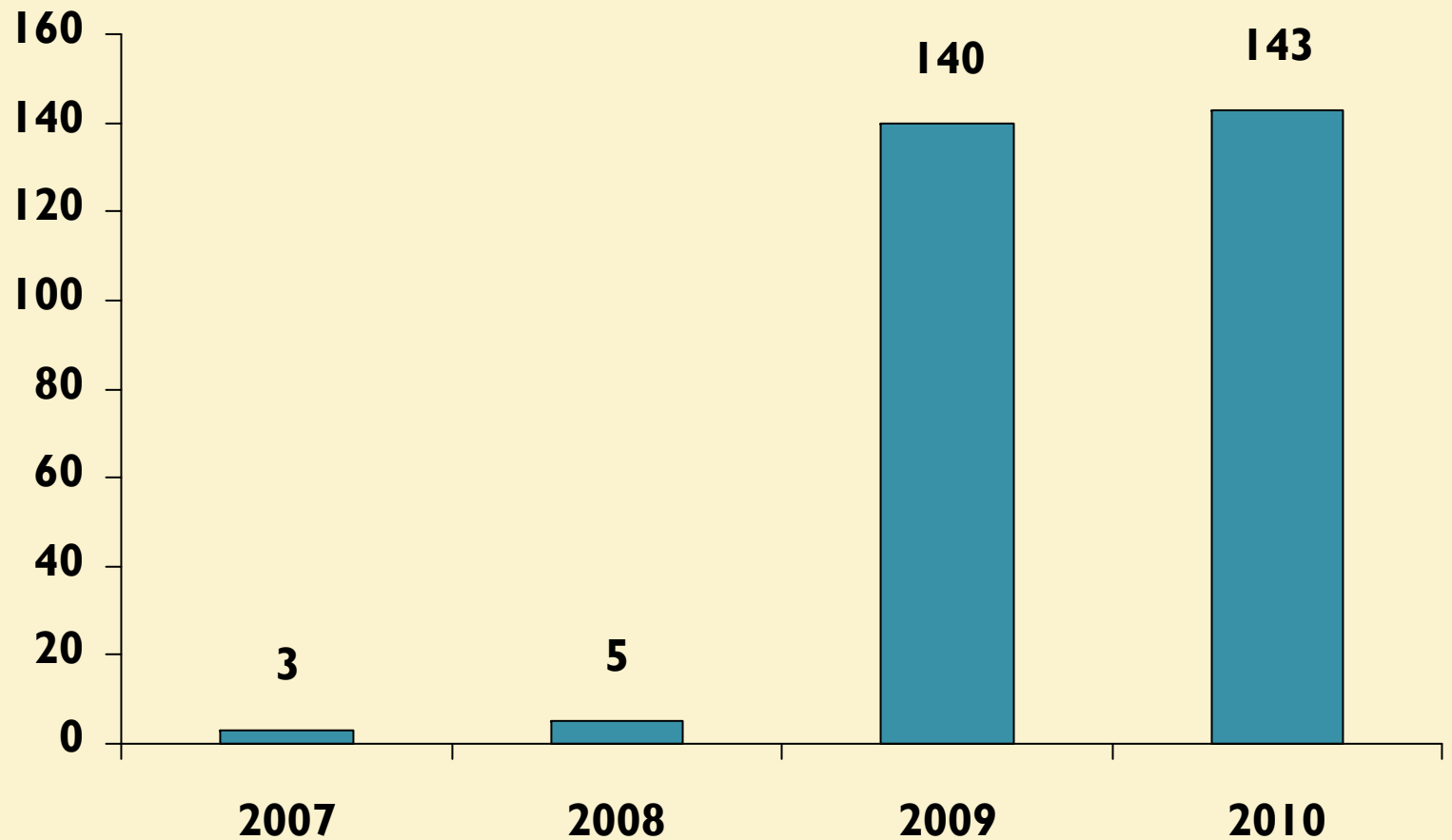
Holders of Municipal Securities

- Remarkably stable
- Average 36% held by individuals (1997-2009)
 - High 39% in 1996
 - Low 34% in 2007 and 2008
 - 36% in 2009
- Mutual Fund next at 35% average

Changing Players

- Fewer truly local underwriters active in bidding on your bonds
 - Northland, Piper, Cronin, Dougherty, UBB
- National firms with local presence
- Reduced presence of community banks
 - Tighter investment criteria
 - Fewer banks

Bank Failures



Source: FDIC

Bond Insurance

- **50% of ALL** new issue volume in 2006 was insured.
- 2010 – little or no role in this market
- 2006 “AAA” rated insurers = 7
- 2010 “AAA” rated insurers = 0
 - Assured Guaranty downgraded to “AA+” in October

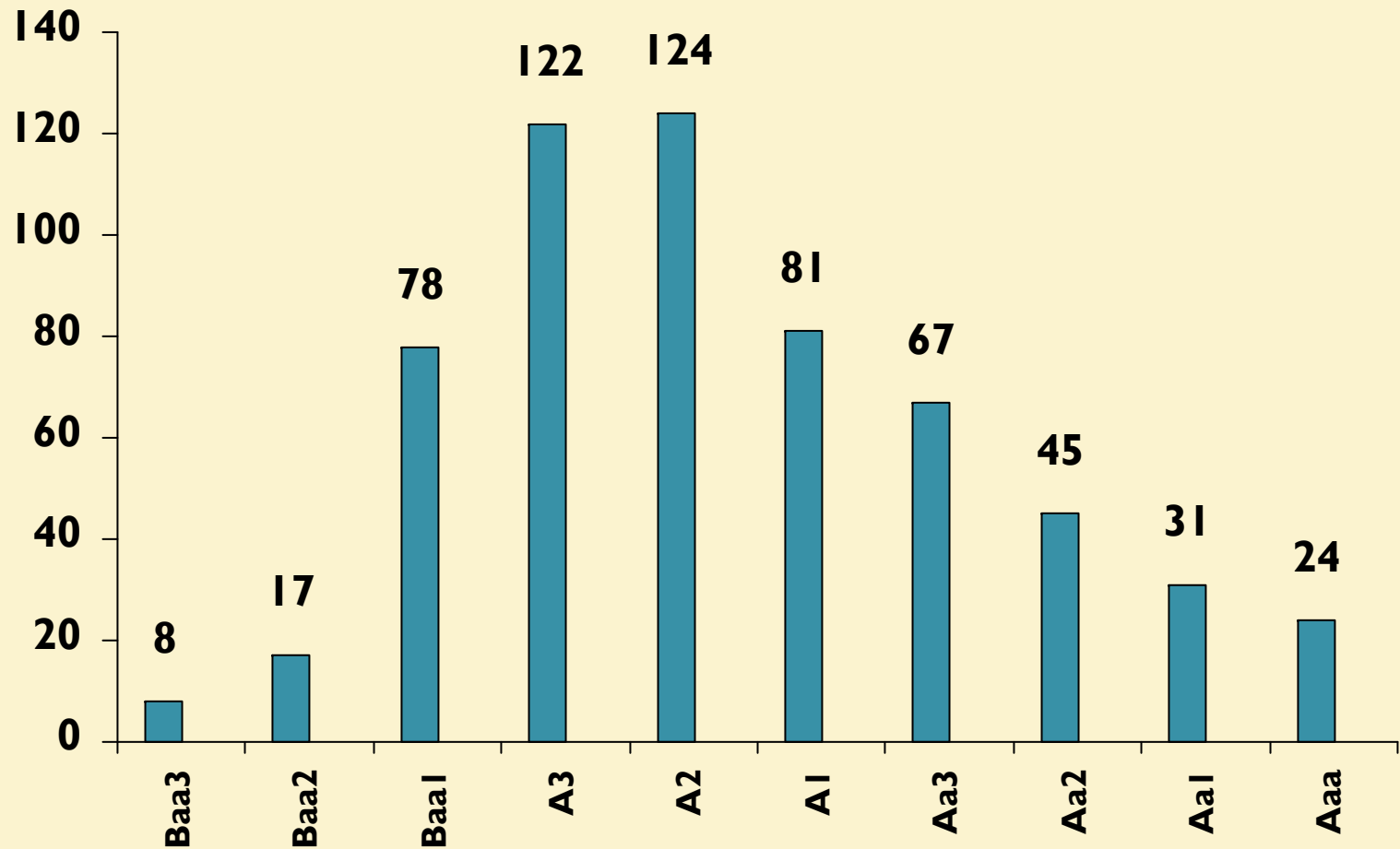
Rating Recalibration

- Align municipal and corporate ratings
- Both Moody's and Standard & Poor's

Closer Look at Moody's

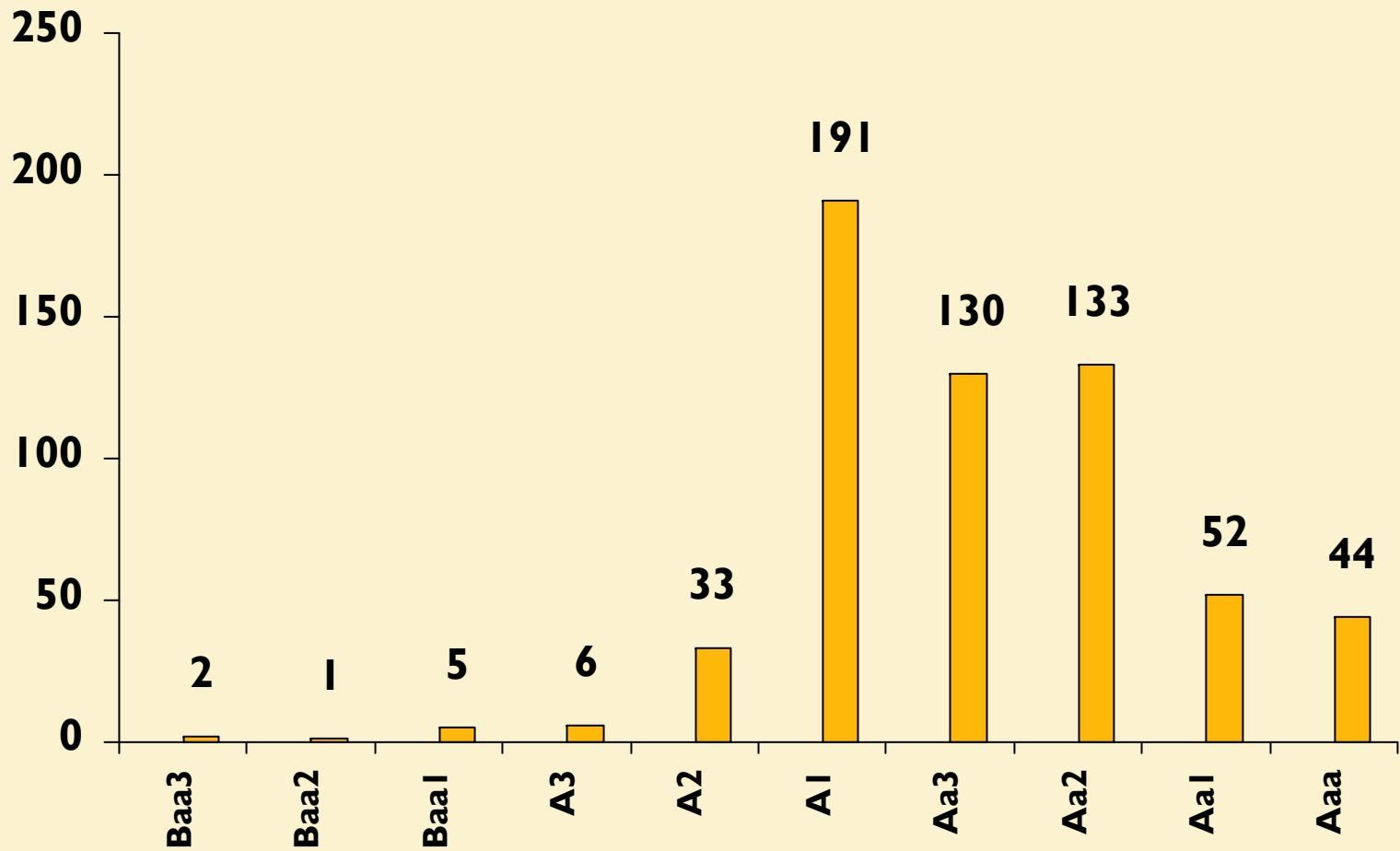
- Recalibration list – April 16, 2010
- 3,100 rated issues in Minnesota
 - Jurisdictions with multiple rated issues
- Approximately 597 distinct ratings
 - Political subdivision
 - Type of debt (G.O., revenue, lease revenue)

Before Recalibration



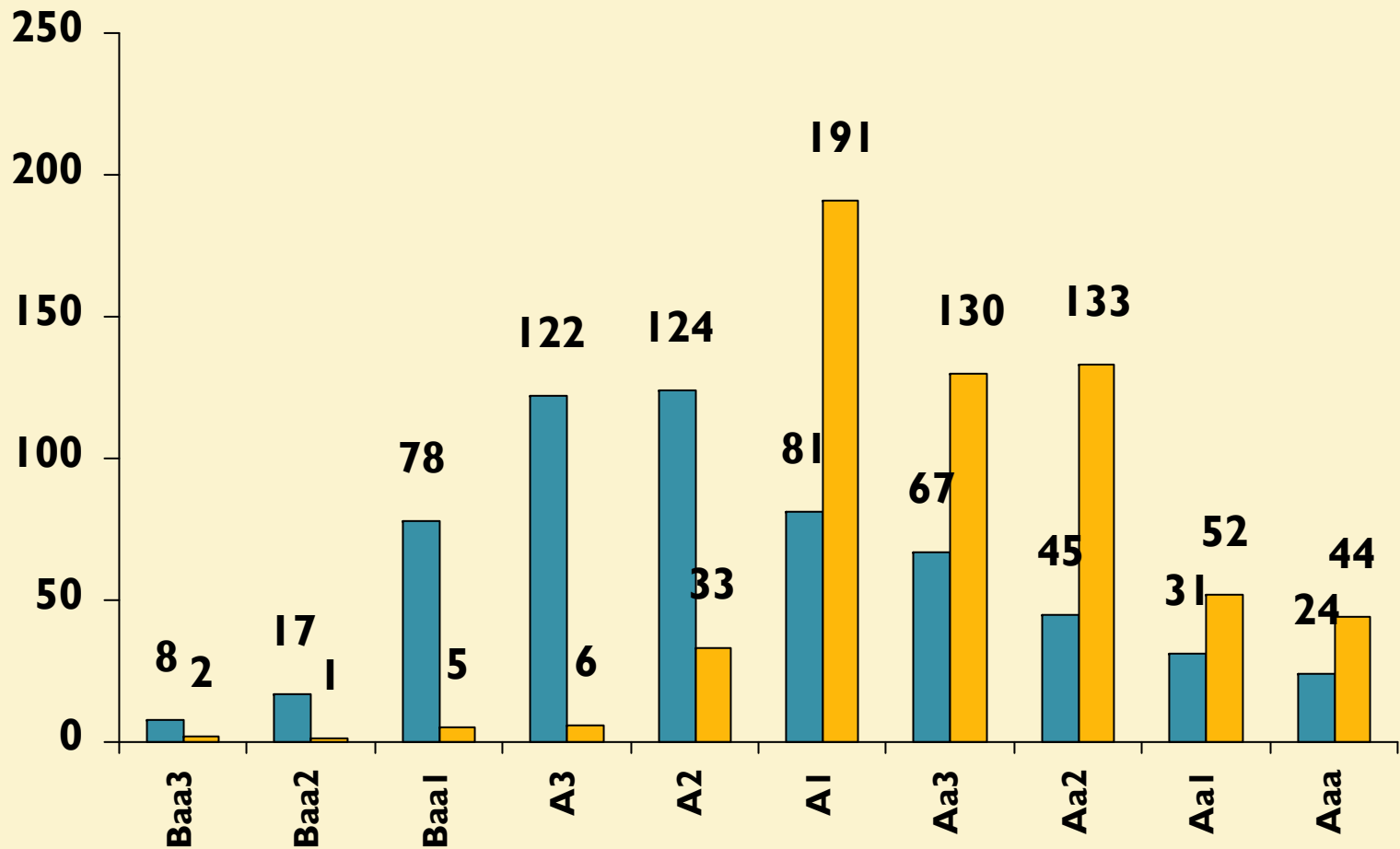
Source: Moody's Investor's Service – Reported Recalibrated Ratings 4/16/10

After Recalibration



Source: Moody's Investor's Service – Reported Recalibrated Ratings 4/16/10

Comparison

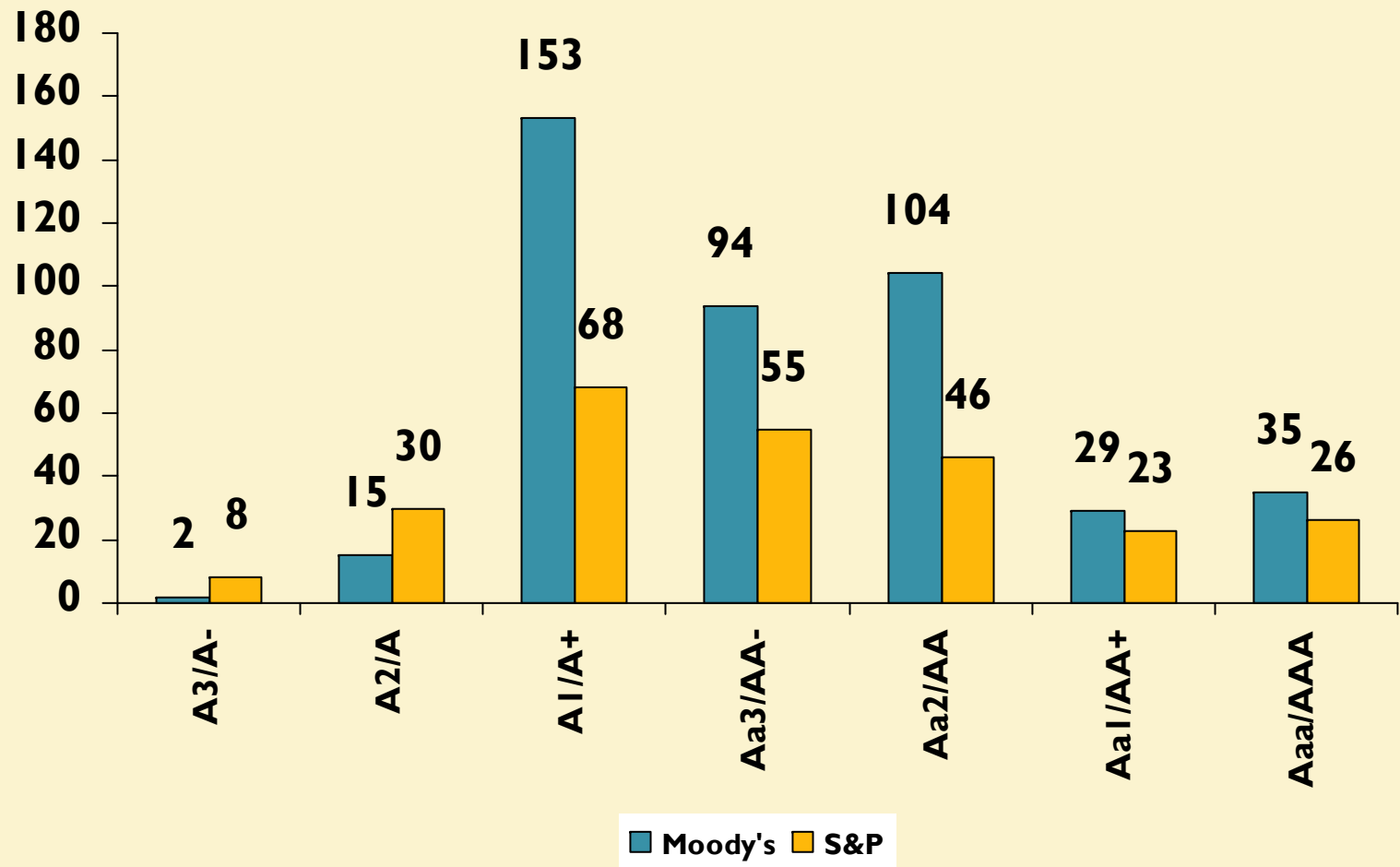


Source: Moody's Investor's Service – Reported Recalibrated Ratings 4/16/10, Standard & Poor's 6/30/10

Effects of Recalibration

- Before recalibration
 - 28% of ratings Aa3 or higher
 - 17% of ratings Baa1 or lower
- After recalibration
 - 60% of ratings Aa3 or higher
 - 1% of ratings Baa1 or lower

Comparison – Moody's / S&P G.O. Bond Ratings



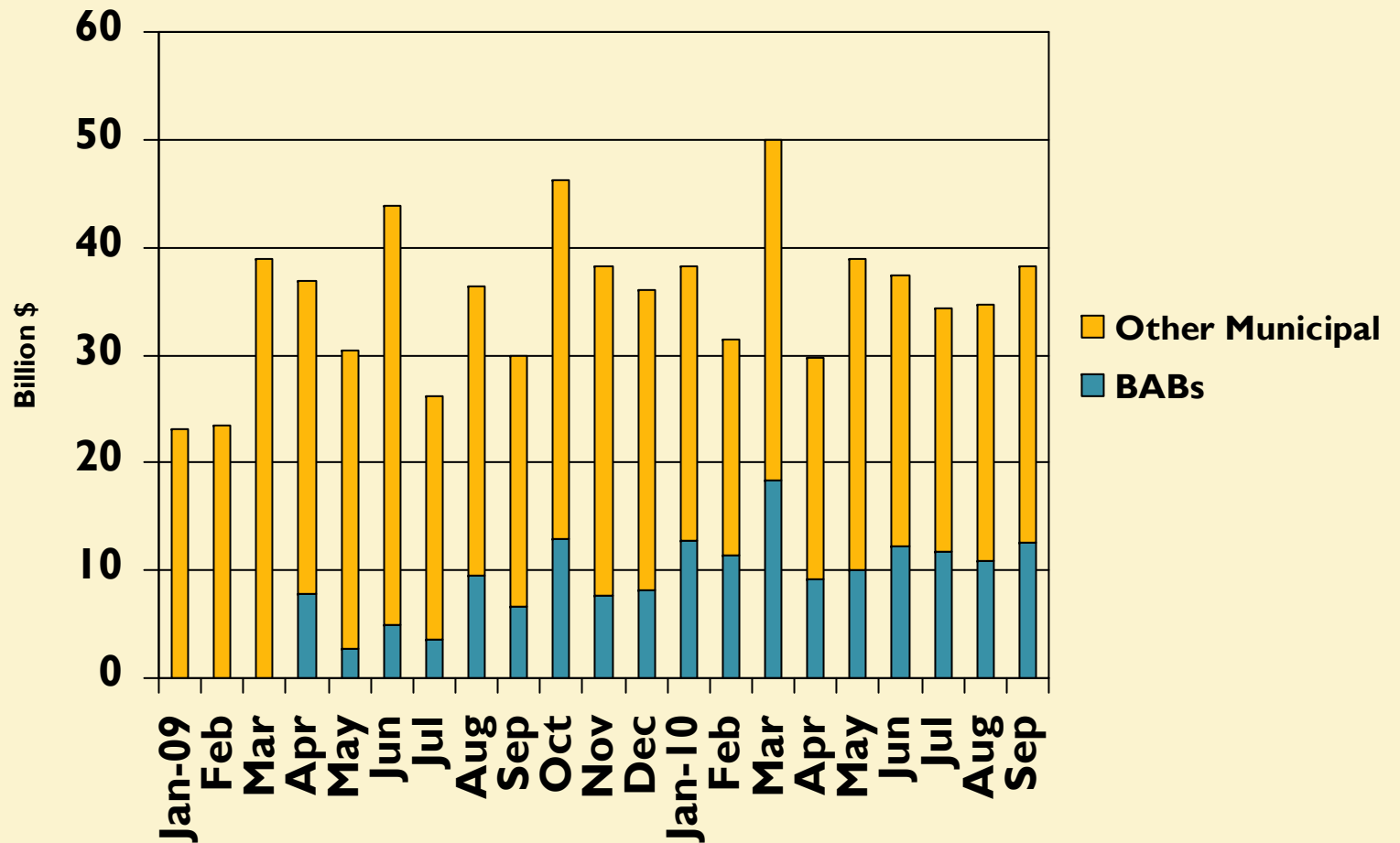
ARRA

- American Recovery and Reinvestment Act
- First direct payment interest subsidy bonds
- Temporary relief from:
 - Alternative minimum tax
 - Bank qualified bonds cap

Build America Bonds

- BABs
- Taxable bonds with 35% federal interest payment
- Significant factor in bond market 2009-10

Build America Bonds

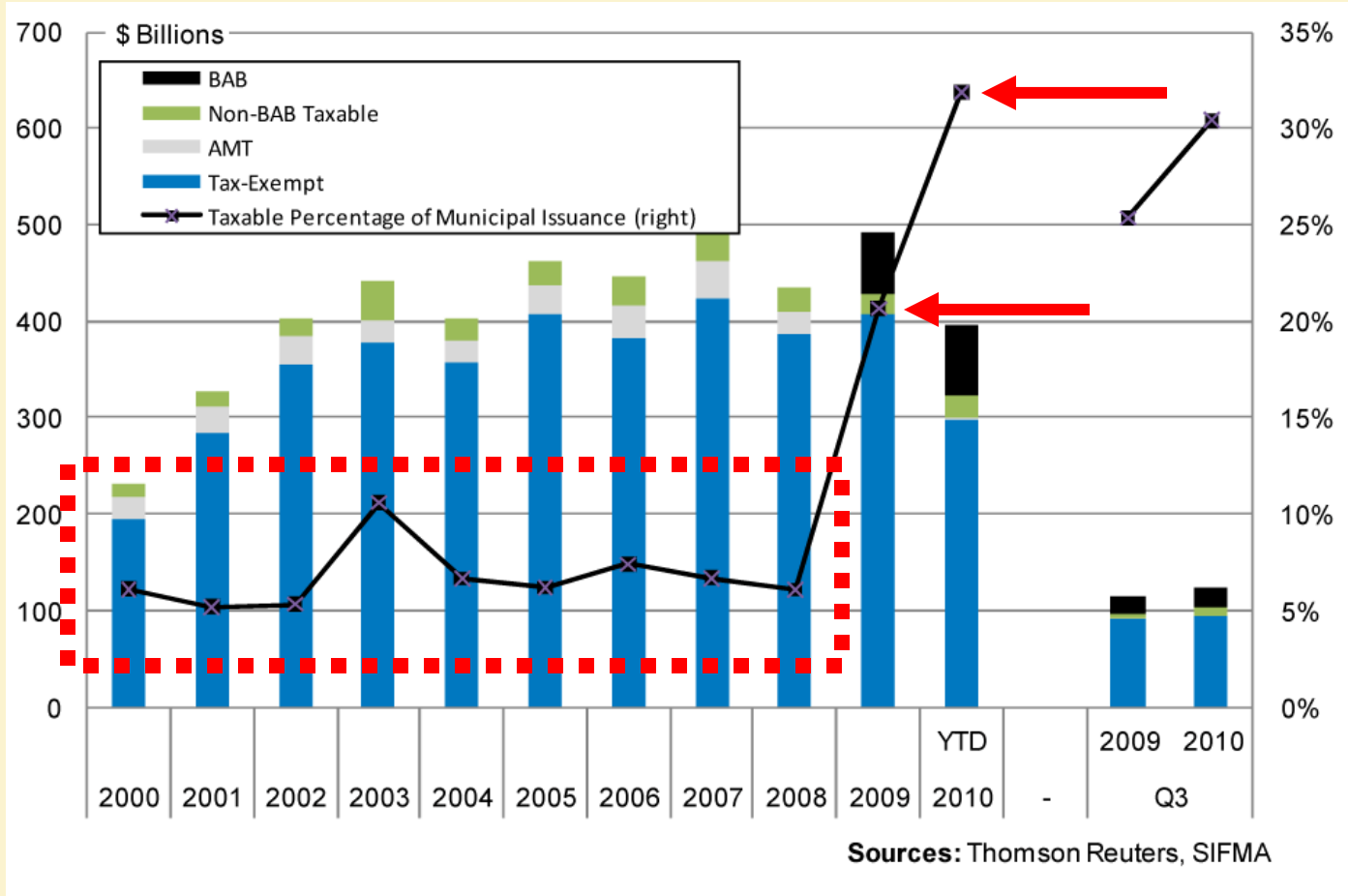


Source: SIFMA (Bloomberg, Thomson Reuters, SIFMA)

Build America Bonds

- 22% of total municipal issuance since April 2009
- 25% of total municipal issuance in 2010
- New investors seeking taxable munis
- Different expectations
 - More credit sensitive
 - Very limited market for non-rated taxable
 - Seek larger “blocks” of bonds

Impact on Taxable Market



Source: SIFMA (Build America Bonds Fact Sheet 3Q 10)

The Witching Hour Approaches

- Variety of ARRA provisions end 12/31/10
 - BABs and Recovery Zone Bonds must be issued by 12/31
 - Annual small issuer “bank qualified” limit falls from \$30 million back to \$10 million
 - Alternative Minimum Tax (AMT) applies again to certain issues.
- Action to extend is uncertain (unlikely?)

Inside the Sale Process

- Most issuers only see the results of the process
- Important to understand what happens inside this “black box”
- Differences in process between competitive and negotiated sale

Competitive Sale

Picking Issues to Bid

- Prepare the bond sale calendar
 - Developed on Wednesday and Thursday prior to sale week
 - Sale information from email notifications, PARITY and Bloomberg
- Obtain POS & rating report from F.A.
 - Basic terms such as issuer, par amount, security, credit rating call feature

Municipal Calendar

COMPETITIVE

AMOUNT	RATING	ISSUE	MATURITIES	SALE
Monday - November 15th				
7,215,000	M-BQ	Village of Fontana-On-Geneva Lake WI GO Corporate Purpose Bonds, Srs 2010B	Mar 11-29	10:00 AM
1,615,000	M-BQ	Pine City ISD 578 MN GO Alternative Facilities Refunding Bonds 10A	Feb 13-24	10:00 AM
13,500,000	S&P-BAB	Maple Grove MN Taxable GO Capital Improvement Plan Bonds 10C	Feb 12-26	10:30AM
2,015,000	S&P- BQ	Maple Grove HRA MN Housing Development Refunding Bonds (GO) Srs 10A	Feb 12-17	10:30 AM
3,010,000	Rated-BQ	Ankeny IA Sewer Revenue Bonds, Srs 2010E	May 12-30	11:00 AM
2,720,000	S&P-BAB	Shoreview MN Taxable GO Bonds, Srs 2010B	Feb 12-26	11:00 AM
4,695,000	S&P-BQ	Shoreview MN Refunding Certificates of Participation, Srs 2010C	Aug 12-23	11:00 AM
1,780,000	S&P-BQ	Crow Wing County MN GO Airport Improvement Refunding Bonds, Srs 2010A	Feb 12-22	12:30 PM
1,100,000	S&P-BQ	Benton County MN GO Capital Improvement Refunding Bonds, Srs 2010A	Feb 12-18	1:00 PM
Tuesday - November 16th				
2,695,000	S&P-BQ	Houston County MN GO Capital Improvement Plan Bonds, Srs 2010A	Feb 13-22	9:30 AM
5,255,000	S&P(enh)-BQ	Houston County MN GO Jail Bonds, Srs 2010B	Feb 22-31	9:30 AM
5,950,000	M-S&P-F-NBQ	Minneapolis MN GO Improvement Bonds, Srs 2010	Dec 11-25	10:00 AM
1,190,000	M-BQ	Eden Prairie MN GO Permanent Improvement Revolving Fund Bnds Srs 2010A	Dec 11-25	10:00 AM
1,780,000	M-BAB	Scott County CDA MN Governmental Development Bonds (GO) (BAB)	Feb 17-28	10:00 AM
4,445,000	M-RZED	Scott County CDA MN Governmental Development Bonds (GO) (RZED)	Feb 28-45	10:00 AM
450,000	M-Taxable	Scott County CDA MN Governmental Development Bonds (GO) (Taxable)	Feb 14-17	10:00 AM
1,550,000	M-BQ	Rosemount MN GO Utility Revenue Refunding Bonds, Srs 2010A	Feb 12-18	10:30 AM
1,350,000	M-BQ	Rosemount Port Authority MN GO Public Facility Refunding Bonds, Srs 2010B	Feb 13-22	10:30 AM
3,560,000	S&P-BQ	Cannon Falls MN GO Water Revenue Refunding Bonds, Srs 2010A	Aug 11-21	11:00 AM
8,030,000	M-BQ	Black Hawk County IA GO Bonds, Srs 2010B	Jun 12-23	11:00 AM
Wednesday - November 17th				
1,350,000	NR-BQ	Village of Lac La Belle WI GO Refunding Bonds	Apr 11-23	10:00 AM
3,500,000	S&P-BQ	Wabasha-Kellogg ISD 811 MN GO School Building Refunding Bonds, Srs 2010A	Feb 13-24	10:30 AM
11,465,000	M-RZED	East Bethel MN Taxable GO Water Utility Revenue Bonds, Srs 2010A (RZED)	Feb 20-40	11:00 AM
6,135,000	M-BAB	East Bethel MN Taxable GO Utility Revenue Bonds, Srs 2010B (BAB)	Feb 16-40	11:00 AM
925,000	M-Taxable	East Bethel MN Taxable GO Bonds, Srs 2010C	Feb 16-17	11:00 AM
5,820,000	M-BAB	Alexandria ISD 206 MN Taxable GO Alternative and Capital Facilities Bonds (BA	Feb 14-25	11:30 AM
3,365,000	M-BQ	Osage Municipal Utilities IA Electric Revenue Refunding Capital Loan Nts 10B	Dec 11-18	1:00 PM
Thursday - November 18th				
4,885,000	Aaa - BQ	Three Rivers Park District MN GO Bonds, Srs 2010	Feb 12-16	11:00 AM
5,520,000	Rated - BQ	Clive IA GO Refunding Bonds, Srs 2010A	Jun 12-22	1:00 PM
Friday - November 19th				

Competitive Sale Internal Review

- Flag issues that require credit committee approval
- Some issues cannot be bid
 - Each shop has different requirements
- Need extra time
 - Typically Thursday p.m. or Friday a.m.

Competitive Sale

Refine the Calendar

- Firms are selective - it's easy to say no
- Only so much human and capital capacity
- Quickly determine what issues will not pass credit committee or if there is time

Competitive Sale

Refine the Calendar

- Further whittling down is more subjective
 - Not enough \$ / unworkable caps on price spreads
 - Short call dates
 - Long settlement dates – beyond 45 days shorter for BABs
 - Good faith check requirements
- Not a clear understanding of the project or security can eliminate an issue – no time to dig into details
- Arrive at the targets
 - Where can I find value.....

Competitive Sale

Pre-Marketing – Sales Meeting

- Every Friday morning
- Upcoming bond sale calendar is presented and discussed with the “Institutional” and “Retail” sales force
 - Institutional buyers - trust departments / money managers, mutual funds, insurance companies, large regional banks
 - Retail buyers – community banks and individuals

Competitive Sale

Pre-Marketing – Sales Meeting

- Traders outline the bond issues they expect to pursue and solicits input on any others
- Links are established to POS and credit rating report on intranet – 1st opportunity for sales to prep potential investors

Competitive Sale Bid Preparation

- Afternoon prior to or morning of sale
- Set up PARITY and good faith check
- Bidding syndicates established if necessary to spread risk

Competitive Sale Bid Preparation

- “Price Talk” – preliminary coupons and yields are developed
 - Based on sale “results”, overall market and perceived competitive advantage
 - Proposed pricing is emailed to sales force for feedback
- Pricing is refined based on internal feedback and external “chatter”

Competitive Sale

Submitting the Bid

- Electronically via PARITY within a few minutes of deadline
- Not all bids are submitted to win

Competitive Sale

Winning the Bid

- Manage risk and capital
- Orders need to be confirmed / “trades” run
- MSRB rules
- Prepare for next issue

Negotiated Sale Calendar

- Driven by time needed to pre market the issue
- Pricing window of 2 – 3 days established
- Credit committee and credit rating dates are coordinated
- Pre – release meeting with sales set up

Negotiated Sale Pre-Marketing

- All about making the issue attractive
- Pre- issue brief distributed and presented to trading and sales 5 – 10 days ahead of pricing window
 - Discussion of project, credit and “sizzle”
- Sales force distributes pre-issue brief along with POS and credit rating report to suitable investors
- Institutional investors call conducted if necessary

Negotiated Sale

Preliminary Pricing

- Trading desk, public finance consultant and issuer client discuss preliminary pricing
 - Feedback from sales/investors
 - “Results” of comparable sales
 - Market trend

Negotiated Sale

Issue Release and Order Period

- Upon approval of issuer client the terms are released
 - Maturity schedule, coupons, yields and call date
- 1 – 2 hour order period
 - Indications of interest from investors are received
 - Amount, maturity, coupon

Negotiated Sale

Final Pricing

- Orders are tallied and subscriptions determined
- Terms and structure may be adjusted until a “market level” is achieved
 - Coupons, yields, call date, structure, “block” size are all considered
- Underwriting commitment is made
 - 70% subscribed in a typical market

So, What Does It Mean?

- Supply/demand concerns
 - Continued strong supply without comparable growth in purchasers
 - Lots of Treasuries
 - Investors can and will be selective
 - Conditions could get worse if taxable purchasers of BABs do not shift to tax-exempts
 - **What makes your issue attractive?**

So, What Does It Mean?

- Changes in impact of rating
 - Shrinking market for non-rated
 - AA is new A
 - Only one piece of the puzzle
 - Slight edge to Moody's in this market
- No bond insurance to mask credit issues

So, What Does It Mean?

- More independent credit analysis
 - Many investors conduct own analysis
 - Will not purchase without OS
 - Double digit debt ratios becoming a concern
- Ying and yang of low rates
 - Benefit to issuers
 - Not appealing to investors
 - Continued series short-lived windows

So, What Does It Mean?

- Be Attractive!
- Be Attractive!
- Be Attractive!
 - Provide flexibility in bid terms
 - Evaluate the call feature
 - Be aware of closing dates
 - Pro-Active disclosure – Investor Relations?

Questions

- Slides will be available on Northland Securities website
- www.northlandsecurities.com/public_finance