

IMPACT OF CREDIT CRISIS ON MUNICIPAL BOND MARKETS

UTAH LEAGUE OF CITIES & TOWNS
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HISTORIC TIMES IN CREDIT MARKET

Fitch Downgrades Ambac to Double-A

Insurer Abandons Plan to Raise Capital

More Hits for Insurers

MBIA Downgraded; FGIC Threatened

Ambac, MBIA Put On Watch

Moody's Cites
Exposure Fears

FGIC Plans to Split In Response to Crisis

Fitch Ratings Lowers XCLA to CCC From BB

Moody's Drops CIFG To Junk

Rating Agency Cites
Potential Insolvency

TODAY'S DISCUSSION:

- 🏛️ What has Changed in the Municipal Bond Market
- 🏛️ The Impact to Issuers of Municipal Bonds
- 🏛️ What Your City/Town can do to Best Prepare for Future Transactions
- 🏛️ Questions

RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

- 1971 AAA Municipal Bond Insurance Emerges
- 1980 only about 3% of Muni Bonds Insured
- 2007 nearly 60% of Muni Bonds Insured
- Viewed as “No-thought” insurance
- Bond Purchasers Spend Little Time on Underlying Credit



OVERCONFIDENCE

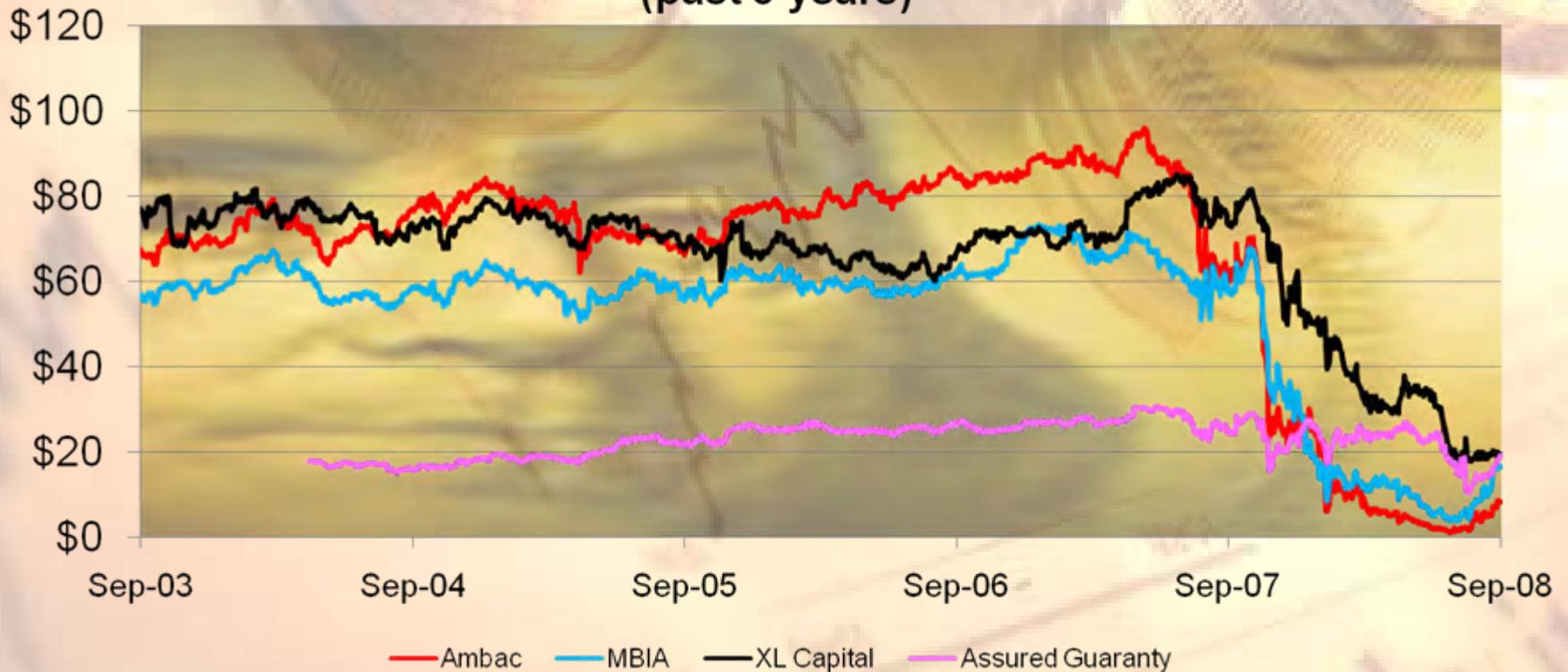
This is going to end in disaster, and you have no one to blame but yourself.

RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

- ☰ 2007 – 7 AAA insurers
- ☰ Now – 2 AAA insurers...both on credit watch for possible downgrade (FSA; Assured Guaranty)

RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

Municipal Bond Insurer Stock Prices
(past 5 years)





ROCK BOTTOM

You'll Know It When You Get There.

RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

- ☰ Insurance Now More Expensive with Less Value
- ☰ Use of Insurance Declining
 - ☰ Jan – Jul 2007 - \$126 Billion of Muni Bonds Insured
 - ☰ Jan – Jul 2008 - \$58 Billion of Muni Bonds Insured
 - ☰ FSA & Assured Guaranty on Negative Watch – Will Slow Insurance Use Even Further

RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

- ☰ Bond Purchasers Digging-In to Each Credit
 - ☰ Takes More Time to Prepare for Marketing
 - ☰ Increased Purchaser Analyst Expenses – May Reduce Bonds Reviewed by Purchasers
 - ☰ More Concern Over Potential Liquidity in Secondary Market

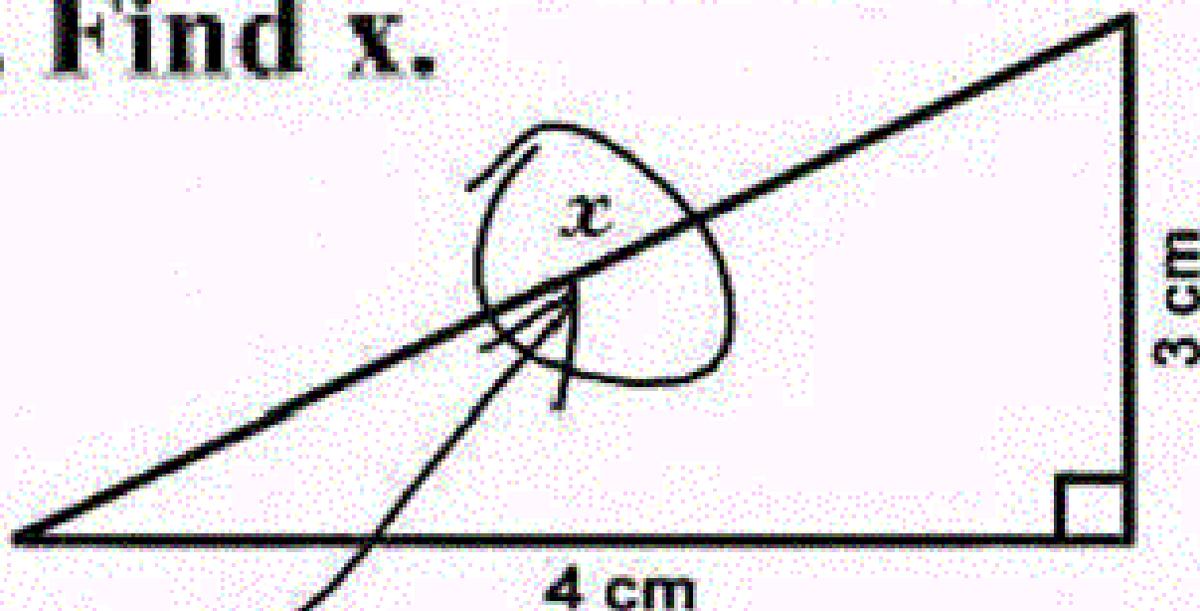
RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

- ☰ Impact of Insurance Market on Municipal Issuers
 - ☰ Insurance Premiums Significantly Higher (if used)
 - ☰ Valued Insurers will “Cherry-pick” Only Very Best Credits and Set Sizing Limitations
 - ☰ May Lead to Less Frequent, Larger Sized Bond Issues
 - ☰ Additional Analysis to Determine Value of Insurance

RISE & FALL OF HOMOGENEOUS MUNICIPAL BOND MARKET

- 🏛️ No Insurance = No Surety Policy
- 🏛️ Increased Bond Size to Fund Reserve Fund – Or Use Cash
- 🏛️ Need to Increase Investment Efficiency of Reserve Fund
- 🏛️ Place MUCH More Significance on Underlying Rating of Each Issue

3. Find x .



Here it is

SIMPLICITY

The simplest solutions are often the cleverest
They are also usually wrong

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

-  **Greater Importance & Relevance of Underlying Municipal Bond Rating**
-  **Increased Scrutiny by Rating Agencies and Credit Analysts**
-  **Interest Rate Spread Between Rating Categories are Increasing**

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

Average Spread AAA & A



- Importance of Municipal Bond (*Credit*) Rating
- \$10M Issue; 20 yr. term
 - \$2M savings between AAA & A rating
 - Significant Savings for local government

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

Four Elements of the Rating Process

 Economic Factors

 Financial Performance & Flexibility

 Debt Factors & Long-Term Liabilities

 Management Factors

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

Economic Factors

-  Economic Base: population, growth in residential and commercial development activity, labor pool, education levels, etc
-  Diversity of Tax Base: (commercial, industrial, retail and residential); employment opportunities
-  Wealth Characteristics of Community: income levels; comparison to average levels within U.S., State and County

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

Financial Performance and Flexibility

 Revenue and Expenditure Structure and Patterns

 Annual Operating Performance

 Financial Leverage and Equity

 Budget and Financial Planning Strength

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

Debt Factors and Long-term Liabilities

 Debt Ratios: debt per capita; debt as % of A.V.; overlapping debt obligations

 Long-term Ability to Meet Liabilities and deferred obligations

 Contingent Liabilities: pension, insurance, (other post-employment obligations)

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

Management Factors

-  Longevity and Experience of Administrative Staff
-  Legislative Experience and Policy Directives
-  Financial Management Assessment (FMA – S&P Guidelines)

SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD

STANDARD
& POOR'S

RatingsDirect

RESEARCH

A Year Of Financial Management Assessments Shows A Correlation Between Scores And Credit Strength

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Financial Management Assessment

1. Standard & Poor's implemented in 2006-2007
2. Created more objective manner to assess and evaluate financial management practices
3. Indications that as much as 35-50% of the credit rating would be based on FMA

SHAPING YOUR BOND RATING

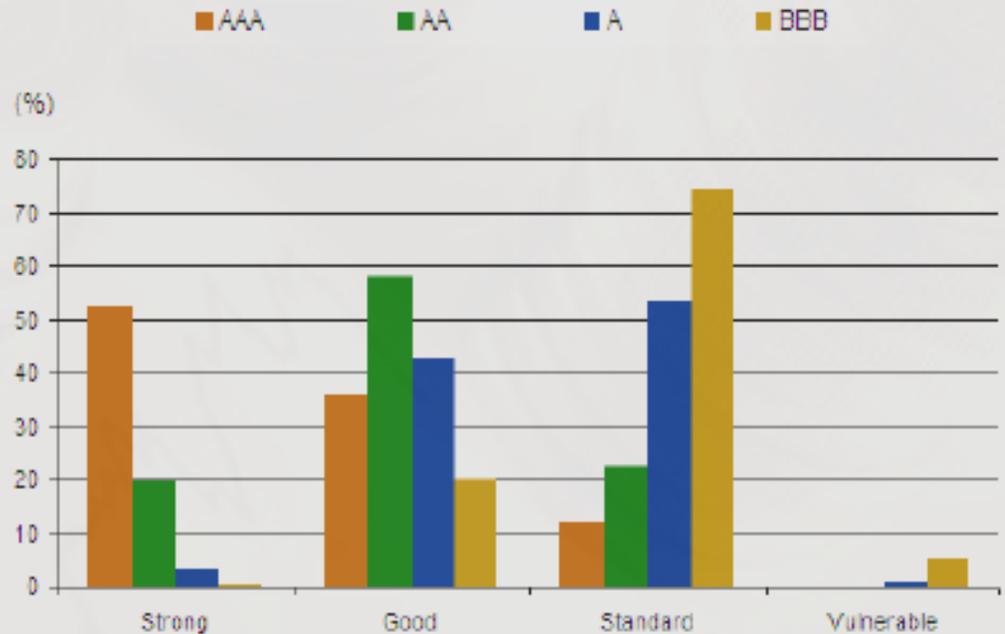
PUTTING YOUR BEST FOOT FORWARD

What is “FMA”?

➤ Seven Areas most likely to affect credit quality

1. Revenue & expenditure assumptions
2. Budget amendments and updates
3. Long-term financial planning
4. Long-term capital planning
5. Investment management policies
6. Debt management policies
7. Reserve and liquidity policies

FMA Distribution Across Rating Categories



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SHAPING YOUR BOND RATING

PUTTING YOUR BEST FOOT FORWARD



Solid Financial Planning and Management Will:

- Lower Cost of Borrowing for local government
- Maintain Fiscal Controls
- Prepare for Positive Fiscal Future



UNIQUE

JUST BECAUSE YOU ARE UNIQUE DOES NOT MEAN YOU ARE USEFUL

DIRECT PLACEMENTS

AKA: DIRECT PURCHASES OR PRIVATE PLACEMENTS

What is a Direct Placement?

-  Bonds Purchased by Means Other Than Public Sale
 -  No Underwriter Involvement
 -  Direct Contact Between Issuer and Purchaser
 -  Limited Number of Purchasers

DIRECT PLACEMENTS

AKA: DIRECT PURCHASES OR PRIVATE PLACEMENTS

- ☰ Who Buys Directly Placed Bonds?
- ☰ Banks & Other Financial Institutions
- ☰ Bond Mutual Funds
- ☰ State Agencies
- ☰ Federal Agencies
- ☰ Individuals (High-Net Worth like LYRB Employees)

DIRECT PLACEMENTS

AKA: DIRECT PURCHASES OR PRIVATE PLACEMENTS

☰ Why are Some Bonds Sold as Direct Placements?

☰ Size/Amount

☰ Timing

☰ Interest Rate

☰ Flexibility

☰ Issuance Cost

☰ Short-term

☰ New Issuer

☰ Story Bond

☰ Non-Standard Situation

DIRECT PLACEMENTS

AKA: DIRECT PURCHASES OR PRIVATE PLACEMENTS

- ☰ How Have Recent Market Changes Impacted Direct Placements?
- ☰ Bank's Profitability Decline – Less Demand Tax-Exempt
- ☰ Increase Scrutiny of Issuer's Financials
- ☰ Less Willingness to Fix Rates
- ☰ Shorter Final Maturity Dates

DIRECT PLACEMENTS

AKA: DIRECT PURCHASES OR PRIVATE PLACEMENTS

- ☰ How Have Recent Market Changes Impacted Direct Placements?
- ☰ Increase Demand for Fully Funded Reserve Funds
- ☰ Increased Revenue Coverage Covenants
- ☰ Higher Bank Origination Fees

DIRECT PLACEMENTS

AKA: DIRECT PURCHASES OR PRIVATE PLACEMENTS

- 🏛️ **Keys to Successful Direct Placements**
 - 🏛️ Up-to-date Financial Information
 - 🏛️ Reasonable and Defensible Revenue Projections
 - 🏛️ Wide-spread Dissemination of Bid Solicitations
 - 🏛️ Full Evaluation of Bid Responses (not just lowest bid)
 - 🏛️ Willingness to Consider Creative Strategies



CONSULTING

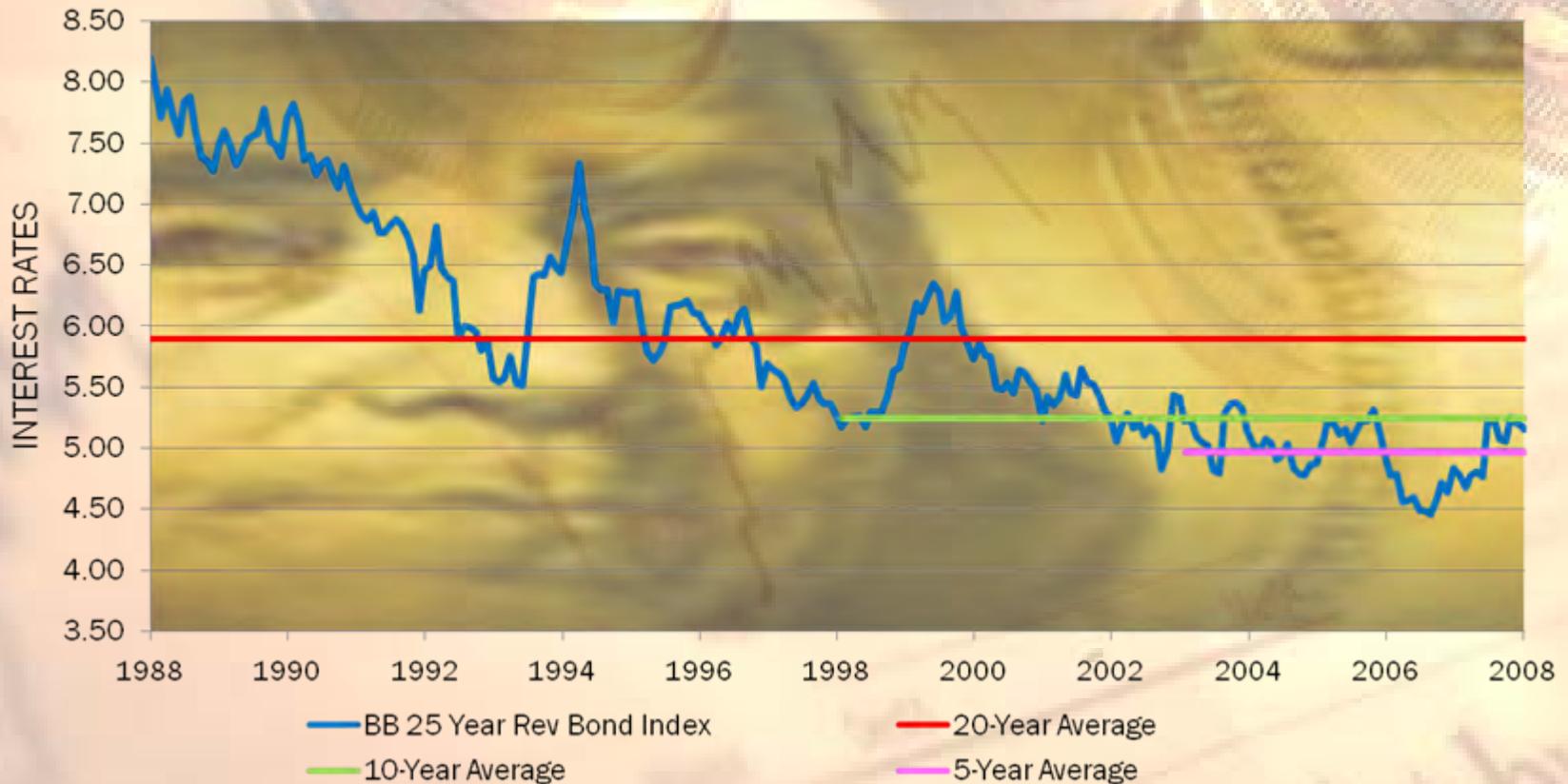
IF YOU'RE NOT A PART OF THE SOLUTION,
THERE'S GOOD MONEY TO BE MADE IN PROLONGING THE PROBLEM.

CONCLUSIONS

- 🏛️ **Get Finance Team in Place Sooner vs. Later**
- 🏛️ **Position City/Town for Best Rating/Market Acceptance**
- 🏛️ **Now is Still a Great Time to Issue Debt...But You Will Need to Be Prepared**

CONCLUSIONS

Bond Buyer 25-Year Revenue Index - Historical Rate



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