Mac Quarterly Newsletter

Municipal Advisory Council of Michigan SUMMER 2012
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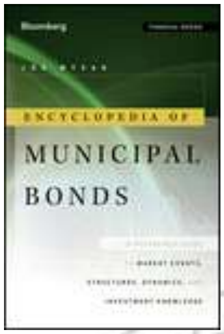
For the Bookshelf
Encyclopedia of Municipal Bonds



Joseph Mysak, of Bloomberg, wrote the recently published book, *The Encyclopedia of Municipal Bonds: A Reference Guide to Market Events, Structures, Dynamics, and Investment Knowledge.*

It's an informative text covering the ins and outs of the bond market. In it Mysak examines municipal market history, taxes, pricing and key market events -- unfolding their nuances in story. Anyone interested in the municipal bond market will find the book a great read. **See MYSAK on Page 2**

THE MAC CONFERENCE

On May 8th, 2012, the Municipal Advisory Council of Michigan offered an informative seminar featuring three top-notch speakers: Ken Weinstein the senior director in state ratings group at Fitch Ratings, Jane Ridley, senior director and analytical manager at Standard & Poors Ratings Services -- for U.S. public finance ratings, and Matthew Butler, the associate analyst at Moody's who focuses on the state of Michigan and local governments. **See the MAC Seminar on Page 4.**

MICHIGAN

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- MICHIGAN IMPROVING! SEE *ALEC* PAGE 6

Intuitive Analytics
A New Software Analysis Tool

If you heard the word engineer twenty years ago, odds are you'd think, "Hmm, they build cars and radios -- and write code." And if you heard the word accountant or "MBA" you might imagine someone running the front office, a group completely separate from the engineers with a much different yet still specialized skill set. In truth, your mental pictures would be pretty accurate too -- in both instances.

Today, in 2012, you'll find engineers in blended occupations -- able to combine multiple passions and talents within industries that might seem far removed from the traditional automotive, aerospace and telecommunications businesses always known for hiring them. **See Intuitive on Page 8**

Private Placement or Public Offering - A Primer

Public offering or private placement? What path should a municipality pursue? Answer: it depends. Consider the following two scenarios.

The Scene: Meet Mary. She's the finance director at a school district in Somewhere, Michigan. Her district is looking at a 15-year period of financing rather than using reserves for a new school sorely needed because of a burgeoning student population. First Mary calls her financial advisor to evaluate options. **See Private Placement on Page 9**

Mysak from Page 1

Mysak began covering municipal bonds in 1981 after joining the Bond Buyer as a copy editor, eventually rising to become publisher and editor in 1992. In 1999 he moved to Bloomberg.

He isn't shy about his lack of municipal bond experience when the Bond Buyer first hired him. "I didn't know anything about bonds. The guy who hired me wanted someone who could write and knew nothing [about bonds] rather than a non-writer who knew the municipal bond market. I figured I'd be there three months. I was into straight news about cats in trees and burglaries not finance, but I stayed," said Mysak who unexpectedly discovered the "fun in finance" and ultimately made a career out of it.

In 1998 Mysak wrote the *Handbook for Muni-Bond Issuers,* a short compendium "for public officials tapping the municipal market," he said. And one day the publisher asked him to update it. Mysak stared at a copy of the *Lincoln Assassination Encyclopedia* while listening to the publisher's suggestion, then offered to write the *Encyclopedia of Municipal Bonds* instead, thinking the outline of the Lincoln book might be a good template to follow. With the publisher's nod, he went to work, quickly putting together a table of contents. He knew the volumes of reference materials he'd collected over the years as a writer, researcher and editor would prove useful while developing the text -- especially for readers wanting to dig a little further and within a year the book was complete.

Mysak's interest in writing the book had some roots in a desire to "counter hysteria about the market that surfaced in 2009 and culminated in Meredith Whitney's '60 Minutes' appearance in December 2010," he said. Whitney told a national television audience that the market would see "hundreds of billions of dollars" in municipal defaults within the next 12 months. Her words prompted a tidal wave of selling in the market but the number ultimately fell as cities worked toward balance budgets; and she lost some credibility.

The book is intended to reach a wide audience: issuers, lawyers, bankers and investors -- sophisticated or not. It's meant to serve as a reference and talks about the market using story. "What happened in Orange County? How did it turn out?" asks Mysak. Answers are in the book, discussed in a logical, relaxed format. If you prefer dry text, look elsewhere. Those books are written by academics.

While the *Handbook for Muni-Bond Issuers* was aimed at elected officials, the *Encyclopedia* is targeted toward a retail and institutional investor. "There are more than six million households in the United States claiming tax exempt interest," said Mysak. "Those are my readers."

The book is an alphabetical presentation of events with key entries "anchoring the text, such as the Arkansas Default of 1933, the auction-rate securities freeze of 2008 and insurance -- which once covered more than 50% of the market and now just 5% or so," he explained. It also discusses the Ratings Recalibration of 2010.

The text highlights "special" market nuances: museums which sell tax exempt bonds for example. "If you buy a museum bond, there are things you should know," said Mysak and it's all in the book. He added, "Anyone looking to buy municipals should rid themselves of the notion that they are all the same. They are not." And investors would do well to examine the official statements for the bond. There's a California market, a New

York Market and others Mysak explained. "The market is fragmented."

One concept covered in detail is yield burning. "It's the systematic overcharging of municipal issuers for the securities and investment contracts they use in reinvestment of proceeds," said Mysak. And it can impact the tax-exemption of an issuer's bonds. Mysak said it's difficult to get rid of because it "happens in the dark, after a bond sale," and only a small group of professionals get involved but Mysak said the Internal Revenue Service has chimed in with, "You can't sell tax exempt bonds and sell them for a profit, then turn around and use the profit for something else."

Trends are another topic covered in the book. Many new municipal bond issues are not insured today and a prudent investor must "be aware of what they're buying," said Mysak.

"Of the households claiming tax-exempt interest, precious few can tell you anything about the municipal bonds or funds they own. Most municipal bond investors seem to think that when they need help, they just buy it. That's a big mistake," he said. And many mistakes are made by the young. Mysak advises investors to do their homework, and look at the credit they are buying. "The municipal bond market is full of investors who are aggressively ignorant," he said.

Mysak is reluctant to name a favorite chapter but does admit to enjoying the escrowed-to-maturity entry, because in researching it, he discovered that the "imbroglio over so-called ETM bonds is the bridge between the old, murky municipal market and the new." He said he hadn't put all the pieces together, though it was a story he'd covered in the past, and even owned for a time.

He entered the scene when the Kansas Highway Department wanted to call bonds that were escrowed to maturity. He said, "You can't take bonds escrowed to maturity and then issue new bonds and call in the old escrowed bonds." The move caused a ruckus and it all played out in glacial fashion.

The book does not try to sell anyone anything and it's refreshing. A brave soul, Mysak is not afraid to be both candid and critical where appropriate. In his own words, "Let's face it. Life has not been lived according to the golden mean in public finance."

Asked to summarize the purpose of the book, Mysak said, "The takeaway is that municipal bonds are particular and specific to an extraordinary degree and those who generalize do not know what they are talking about." He also admits to an interest in debunking some of what Meredith Whitney said in her famed *60 Minutes* interview.

Mysak has a lot to say about derivatives. "In the municipal bond market the term mainly refers to the use of interest rate swaps." He sees it as another scandal, and noted it is costing issuers billions of dollars. Many municipal issuers had no concept of the level of risk said Mysak. "And nobody really understood just how popular swaps were with general government municipal issuers, compared to, say, hospitals or various corporate entities or authorities," he explained. "Those for swaps wanted everyone to think everyone was engaging in swaps." But Mysak believes the real participation rate was much lower except perhaps at the very end of the period when variable-rate debt coupled with swaps was being sold.

When asked, Mysak said he does not see pension obligations impacting the market, with Illinois being the exception. He does believe that scrutiny of pensions and other post-employment benefits is a good thing, though beneficiaries present or soon to be might not welcome it. "But in reality, the problem children are relatively few," said Mysak admitting that some municipalities have given away the store. He added, "Still 'a few' and 'some' does not translate to 'all'."

Readers can purchase the book here: Amazon: Encyclopedia of Municipal Bonds

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MAC Seminar from Page 1

Fitch Ratings

The Fitch presentation reviewed 2011 and considered the remainder of 2012 and beyond, then touched on pensions, a "hot" button word we're sure to hear more about in the months to come.

Some welcome good news: Michigan according to Fitch, carries a positive ratings outlook because of the structural reforms put in place -- and only two states, California and Illinois, have ratings below the AA category.

Michigan

The positive outlook on the credit ratings in the mitten state can be attributed to base economic recovery, better financial management including a solid plan to rebuild the state's rainy day fund this year and next, and a budget plan excluding "one-time" measures. Other improvements come from managing debt -- which remains low.

There is some pressure from post-employment benefits liabilities, but Michigan has passed some legislation to mitigate it. Michigan is currently rated AA- with a positive outlook going forward. Changes in the tax code, shifting taxes away from business, will continue to be phased in and offer further improvement. Additionally Michigan's economic growth should outpace the nation in 2012 -- at 1.7% versus 1.6% for the U.S, according to a Global Insight study.

"Keep in mind, at the end of 2010, Michigan had one-third the automotive jobs in place that it had back in 2000," said Weinstein.

Though Michigan's unemployment rate is still "high at 9% percent, it's nearing the national average [8.4%]," he added which is an improvement. And sales tax revenues are up 5.4% with an increase in personal income taxes seen as well, 7.4%, as of March 2012.

Standard & Poor's Rating Services

Jane Ridley's lively presentation focused on the U.S. local governments and offered insight into newly proposed general obligations rating criteria. She said the intent of the new criteria is to provide better transparency into the rating process, improve ability to compare ratings to similar issues and specifically formalize the forward-looking rating component. Standard & Poor's has asked for a 90 day comment period on the proposed changes.

Specifically, they'd like feedback on five separate issues -- one is simply to ask if people agree with their measures used to evaluate rating factors, and if not, to suggest "how you'd change the measures," Ridley said. Additionally, S&P would like to know if there are other data sources to be evaluated before implementing the proposed criteria.

Ridley launched into an informative explanation of how local GO ratings are established. Many weighted factors feed into the final rating -- institutional framework, the economy, management, certain financial factors and debt. And a host of overriding factors can move a rating upward (positive) or downward (negative). For example, a sustained high level of fund balances would move a rating a notch toward positive. But other factors such as weak liquidity or large negative fund balances could move a rating in another direction -- and override what the "indicated" score should be.

Ridley reviewed the seven factors used in the proposed rating criteria: institutional framework, economic score, management, financial measures, budget flexibility when under stress, budget performance -- budget versus expenses, liquidity and a measure of liabilities -- debt which looks at both debt as a percent of expenditures and debt as a percentage of government funds revenue.

"Debt is incorporated in multiple measures. It factors into the liquidity measurement too," said Ridley. And liquidity looks at "both what's on hand and what's available from elsewhere," she added. "Liquidity looks at quality and robustness compared to peers. For example looking at derivatives...are they being used for investment as opposed to serving a hedging function? This too could impact the liquidity rating," she explained.

The purpose of the proposed changes according to Ridley: S&P wants to improve transparency -- and the new criteria will make it easier to look at different levels of economic stress (and fiscal as well) and rate accordingly.

She said the resulting rating distribution once criteria are finalized and implemented will depend on future conditions and how "local governments respond to those future conditions." The potential ratings distributions are based on the proposed criteria and there are nine possibilities based on two measures: economic and fiscal pressure -- and how management responds.

Local governments have latitude and it's significant with regard to how they "change spending patterns and revenue streams depending on what pressures they face," she said. More than 3700 counties and municipalities were included in the GO ratings. Ridley emphasized that the assessment is "quantitative" only.

Moody's

Matthew Butler, associate analyst at Moody's offered a credit perspective to MAC conference attendees focused on the state of Michigan and local governments.

He looked at several areas of interest, among them recent trends in economic indicators and the impact on revenues, school districts, specific counties and the debt issued for local governments and finally forward looking ratings outlooks.

There is some good news on the Michigan employment front. As of March 2012, "the Lansing, Ann Arbor and Grand Rapids metropolitan areas had unemployment rates lower than the national average," said Butler. But he cautioned, although we're seeing improvements in the economy "improvement in employment is partially explained by a reduction in labor force."

Throughout Michigan, counties have suffered a median 17.5% property value loss since 2006. Property value declines contribute directly to tax revenue reductions and "there's not a lot of flexibility to balance the losses with increased revenues because tax [property] rates are capped by municipal charters," he said.

Further pressure exists because revenue sharing to local governments has waned -- the statutory portion of statewide revenue sharing payment was cut by almost 30% between FY2005 and FY2010 said Butler.

A big issue for schools is district enrollment -- and as populations decline and enrollment dwindles, so does the money coming into district coffers. Additionally there is increased competition for students -- charter schools, online virtual academies and other resources.

Districts were temporarily spared heavy funding cuts because of the stimulus money available, "But that's gone," said Butler. "There was significant reduction in the FY2012 allowance, totaling $470 per student and depending on how a district budgeted for the loss of money has come to the fore recently." There have been numerous downgrades in school district ratings in the past two or three years, said Butler.

Butler then discussed county ratings and risks associated with their debt. He explained that counties regularly issue debt for local governments and the bonds are secured by revenues of the local government -- they might be paid from special assessments paid by developers for example. According to Butler, the special assessment and developer debt is 43%, on average, of the counties' total direct debt. It's an issue and here's why: the county must make the debt service payments if the local municipality can't. And large debt payments "can create problems for counties -- and their finances in the near term," he explained.

Butler reviewed some recent events involving Washtenaw County which issued bonds in 2001 on behalf of Sylvan Township. The township then ran into legal trouble with a developer which led to special assessments collection shortfalls -- and today they are looking at asking voters again to approve a new levy to make up the loss, and considering a consent judgment between the county and the township "or a default judgment levy in the township," said Butler. He also discussed related events in Livingston County.

Looking forward, Butler highlighted the positive, even if a totally rosy projection isn't possible just yet. He did say school districts could see modest improvement in funding next year and though local governments continue to face some pressure going forward, it's to a lesser degree -- tax values are declining, but less so.

SB-1071

Senate Bill 1071 to repeal the personal property tax if passed, will further pressure municipal revenue downward. With some tax credit elimination, it's possible for revenues to stay relatively even but today the outcome of the proposed law is still uncertain.

ALEC - Rich States Poor States Michigan on the Move: Upward

The 5th anniversary edition of *Rich States, Poor States, the Alec-Laffer Economic Competitive Index* was released in April 2012. Stephen Moore of *The Wall Street Journal,* Arthur Laffer, founder of Laffer Associates and Jonathan Williams director of the Center for State Fiscal Reform and the Tax and Fiscal Policy Task Force at the American Legislative Exchange Council each shared their own insights and answered questions during a press call. Later, Williams, a Michigan native and graduate of Northwood University was gracious enough to consent to a one-on-one interview to more fully discuss Michigan against the backdrop of other states and the nation as a whole.

For the unfamiliar, the *Alec* report, *Rich States Poor States,* is a comparative study of the effect of taxes on prosperity and economic growth within each of the 50 states in the U.S. In the first chapter, the authors identify which states "win" and which states "lose" in the Alec-Laffer State Economic Competitive Index rankings for the past five years. The second chapter discusses state economies and specific policy variables affecting them. These include corporate and personal income tax rates. Next they tackle the death tax -- highlighting where it's most advantageous to die from a tax perspective and finally, the last chapter ranks each of the 50 states in terms of economic performance, a 10 year backward look at population and personal income growth, and economic outlook -- a forward looking measure based on specific variables including sales tax burden, top marginal personal income tax rate, number of public employees per 10,000 of population among others.

Of note said Williams, "The top five for five years, in terms of economic growth are Utah, South Dakota, Virginia, Wyoming and North Dakota. The bottom five includes Hawaii, Maine, Illinois, Vermont and New York, for four of the past five editions of the book." A closer look reveals that tax policy plays a role in the success of the economic growth leaders.

The report summarizes its findings in comparative terms offering a takeaway simply worded in just one sentence: "Be more like Texas and less like California." California has a progressive tax structure and a 10.3% top marginal personal income tax rate. The top corporate rate is 8.84%. "Texas has enjoyed the biggest population growth over the past decade, fueled mainly by low taxes. High taxes drive businesses and people away," said Laffer.

Moore said, "Job growth in states with no income tax enjoyed ten times higher employment than the rest of [the] states. States with high income tax didn't see this. They lost 2% employment and California sticks out as a good example. They lost 5% or so of available jobs in last decade." Illinois has also lost jobs because of high taxes, the report showed.

MICHIGAN - On the Road Again

In Michigan there's been big news. Governor Rick Snyder balanced the budget without increasing taxes and eliminated the MBT, Michigan's onerous business tax. According to the report, the MBT elimination "represented a tax cut of $1.67 billion to job creators." And Michigan, "now creates two jobs for every one they were producing and that's good news," said Laffer. The MBT really hurt big retailers who sold high volume goods with low profit margins.

The effect of tax rates on business climate couldn't be illustrated any better than a chart included in the report listing states with the highest and lowest margin personal income tax for the past 10 years, and their economic growth during the same period.

States like Alaska, Florida and Nevada with no personal income tax enjoyed 12.1%, 15% and 28.9% population growth, while states like Ohio, Maine and Maryland with 8.43%, 8.5% and 8.7% personal income tax rates, saw 1.2%, 3.4% and 7.4% population growth respectively.

To summarize, on average the nine states with no personal income tax enjoyed a 13.65% population growth and the nine states with the highest personal income tax averaged a 5.49% population growth over the same period.

Besides taxes, unionization is an issue affecting economic growth. For Michigan's economic climate to continue to improve, the state should, "Look at right to work because unions are an issue," said Williams.

"It puts pressure on Michigan employers. Manufacturers, who want to operate in the United States, go to the southern states, businesses like Boeing -- they want to go to South Carolina." As of May 2012, a dispute between Boeing and the National Labor Relations Board has not been settled. The NLRB prevented Boeing from opening up shop in South Carolina and leaving Washington, over union issues. As pressures mount, more issues are sure to crop up.

Williams said, states have brands just like goods, and taxes are part of the brand. They do matter. Right to work legislation finally passed in Indiana, this past February and *Alec's* report data will reflect the change next year.

The report noted some trends indicating that businesses have accelerated movement from union to right to work states in the past few years and the team will keep an eye on data over the next few reporting seasons to see how they play out.

Michigan still has a ways to go. There's no denying it. The *Alec* report notes Michigan's economic performance and ranks it dead last among the 50. Anybody living in Michigan knows the past 10 years have been anything but fun. However, population decline has slowed drastically and personal income per capita is healthily on the rise. Employment ranks are showing signs of life too. Going forward things look brighter. Economic outlook, a forward looking rank places Michigan 17th among the states, up from 25th in 2011 and 26th in 2010. The huge jump in large part can be attributed to tax reform.

To read the entire report and learn more about the authors visit: www.alec.org.

Intuitive Analytics from Page 1

Nowadays top engineering talent is sought after by investment banks, who hire professionals to serve in analyst, statistician or other math-heavy roles. And the market for those with analysis and deductive capability hailing from top schools is likely to remain hot for years to come.

That's how Peter Orr, founder of Intuitive Analytics, a software company he built from scratch got his start, after spending 14 years in the finance and investment banking business serving in a variety of roles. He's a financial engineer devoted to creating tools to make assessments, analysis and decision-making easier for leaders in the financial market world.

"I was a financial advisor, investment banker and a swaps and risk management professional before I started this," he said. "Then one day, I started to see a need for better deduction tools, and more analysis capability than was currently available at the time."

So, armed with a degree in applied mathematics, an engineering background and strong computing skills, Orr developed the new analysis software, *SmartModels* -- and a company, Intuitive Analytics. His earlier work in public finance offered a matchless perspective, a view he's been capitalizing on ever since.

Intuitive Analytics makes several software-based analysis tools within the *SmartModels* suite aimed at "investment bankers and financial advisors and some issuers too. We often work with the people structuring deals," he said.

Today both firms and individuals want more data -- and they want it faster. Intuitive Analytics meets both needs and takes a new approach to data analysis. The firm has developed software capable of analyzing and exploring problems from different angles. For example their tools can evaluate risk from a company's perspective by looking at the price volatility of debt issued, and can also consider the holding period -- if it's long for example, perhaps cash flow at risk or earnings volatility are worth examining. The software is capable of such detailed analysis.

There are so many tools available within the Intuitive Analytics Suite -- that there's something for everyone. What applies depends on a firm's focus. "We deliver smarter public finance solutions and do it faster. Some firms need smarter. Some need faster. One firm might be interested in interest rate simulations to better understand risk, while another if say perhaps a non-profit, well then the *Balance* application tool would be their area of interest," Orr said. This tool examines the effects of market risk on the balance sheet, and creates alternative strategies for efficient use of finite risk.

A productivity based organization would be interested primarily in speed and would use the specific tools focused on meeting that need -- faster results. In one case, Orr said their group modeled the Commonwealth of Massachusetts obligation debt in-house, and did it in an hour -- with extremely accurate results.

In another case, Intuitive Analytics was assisting an investment bank working with issuer clients "to explain to the rating agency how they managed interest rate risk. They used the output from our software to show the rating agencies how they did it, and it saved their credit rating. Then when new issues came out, they ultimately saved between $10 and $20 million in additional fees," explained Orr.

An interesting part of the Intuitive Analytics *Smart Models* software package is *Library* which pulls CUSIP data from the Municipal Security Rulemaking Board's Electronic Municipal Market Access system, commonly referred to as EMMA. "Library is a complete business solution," explained Orr. "It gives users a new perspective through data. Bond counsel or investment banking businesses might use it."

Orr gave an example. If 10 bankers each had 10 to 15 target clients and needed to keep track of 40 to 50 CUSIPS, the bank would hire analysts to "download official statements and key in data and that has value because analysts get familiar with what the data does. But at some point the marginal value of doing so, begins to wane," he explained. "Library is simply a warehouse for those issuers and borrowers that someone might find worthy of tracking."

Part of the *SmartModels* suite focuses on debt and derivative structuring and offers opportunity to evaluate cash flow risk -- allowing a user to input system constraints to perform "what if" analysis. A segment called *Structure* is a bond sizing and structure tool -- it's a visual modeling tool. Users can import bond data, solve for refunded bonds based on certain revenue constraints and interactively consider a variety of yield scales.

Public finance is an information business said Orr. "And we're trying to help people process the information such that richer information is provided, to make better decisions." He said, "There's a zipper line between finance and technology and we see an opportunity to bridge the gap with our software." Issuers, advisors, underwriters and investors will find it worth more than a passing glance. To learn more, click here: For Public Finance Professionals and follow the link of interest.

CHOICES: PRIVATE PLACEMENT OR PUBLIC OFFERING - A PRIMER

Scenario One – Private Placement: Mary works with a single investor (through a placement agent) and receives credit approval for $30 million to add the new building. Mary gets to decide how she wants to make payments and after evaluating a variety of options she decides to make monthly payments in arrears – it seems the best choice for her situation. Payment structuring is set up to allow prepayment in full on a payment date, just in case the school district gets a sudden inflow of funds.

On the investor side, an in-house team of legal and finance gurus perform credit analysis and a thorough legal review – to be sure all applicable laws are followed. After approvals are received, the investor and school district get down to business – and funds get deposited into an account for the school district's use. When a payment is due, the investor in need of repayment sends in an invoice, and in a few days the payment is made.

Scenario Two – Public Offering of Municipal Bonds: In this case, Mary decides to make a few calls. Working closely with a financial advisor, options are discussed and evaluated. The financial advisor helps Mary hire underwriters, determine a credit rating and establish what the repayment period on the bonds should be. A local investment bank is asked to look at selling bonds to the public debt market – maybe it's a better deal for her school district. The banker tells Mary she can lengthen her loan term from 15 years to 20, or even 30 years. But there are some costs associated with it including legal fees, ongoing disclosure and underwriting to name a few. Working with her financial advisor, she makes a decision: "I'll stick with 15 years."

Next, ratings agencies are contacted to get a credit score on the bonds, trustees are secured -- who will collect the payments and then bond counsel verifies the transaction paperwork is completed properly – including official statements. If Mary elects to go this route, the investment banking firm purchases the bonds and then resells them to investors.

Back in the Real World …

Paul Stauder, first vice president at Stauder Barch & Associates, Michigan's oldest independent public financial advisor firm, and MAC board member, said, "We're seeing a rise in private placements. More commercial banks are buying for their own portfolio and in some cases they can be a good deal for municipalities."

Stauder said, "The cost of accessing capital can be reduced because [municipalities] can forego certain costs of issuance. Costs of underwriting, credit ratings and official statements, those costs are not there." But he cautioned that just because upfront costs have been reduced or eliminated altogether doesn't mean it's the best deal. "You must measure and weigh upfront costs against the interest rate you can achieve on the transaction to see if you are better or worse off," he explained.

Most commercial banks participate in a five to 10 year term loan, he said. When the time period gets longer, it's harder to get a deal. Greg Baracy, a director within the investment banking arm of the firm Great Lakes Capital Markets (formerly Leonard Capital Markets), a division within Michigan's largest independent brokerage said, "We see most looking at 10 year terms, but some do go for 15."

He added, "If someone is looking at financing for 30 years, then a private placement makes no sense. But for shorter terms, there's potential for a lot of expense to be avoided. It just depends on the situation."

Both Jack Brusewitz, senior managing director at Great Lakes Capital Markets and Stauder have noticed an uptick in private placements over the last 18 months with loan proceeds being used primarily for refinancing existing bond debt and periodically to finance new capital improvement projects.

A lot of analysis goes into determining when private placement works and when it does not. "It makes sense when the cost of the transaction and the interest rate achieved is more beneficial than what would be achieved in a public offering. In cases where the credit rating is a bit lower, it is not necessarily good to get exposure to the municipal market as a whole [public offering], and a private placement can be an excellent alternative," explained Stauder.

He added that private placements become more attractive when credit rating issues surface in part because the situation allows parties to discuss one-on-one what structure meets needs on both sides. "Benton Harbor used private placement for cash flow borrowing with a private bank recently," said Stauder. "It kept the costs down, allowed for an attractive finance rate, and the investor was comfortable with the transaction." Everyone was satisfied.

Real advantages do exist. "From the viewpoint of the smaller [municipality], the cost of issuance is lower so in a private deal it's possible to save money up front. We are seeing deals done now, that wouldn't be done if a public offering was the only option," said Brusewitz.

But there are factors that come into play, "just like in a competitive deal," he said. "If a municipality has a credit rating that isn't the best, and there's a possibility that financials don't support the opportunity or effort to go to the marketplace, or there are questions about validity or financial well-being, then it can be much harder to deal, than if the credit rating is at least investment grade. "

Baracy said, "In a private placement from the issuer standpoint, cost can be four or five times less than seen in a public offering." But there's more. "You reap real and direct savings. When firms state negotiated or competitive deal interest rates, those are somebody's best guess. Our rates are firm," he said. He likened the savings seen in private placements to the old axiom: *A bird in the hand is worth two in the bush.* "With private placement it's bird in the hand, real savings." Baracy said.

Other factors to consider include timing. "With private placement, you can take what's on the table," said Baracy. "With public offering through the marketplace, it's true, [interest] rates might be better in a few weeks. But it's a gamble. Take what you can now, or wait for what may or may not turn into a better deal later. There's no guarantee," added Brusewitz.

What Drives Private Placement and Who Buys

Private placements are not usually driven by issuers of debt. They are driven by availability of capital at commercial banks.

"When banks have capital to lend, they will seek to put it to work. Issuers of debt benefit from the situation. But this can always change, as liquidity and availability of capital at banks moves over time," said Stauder.

Stauder advises any issuer of bond debt to seek out multiple offers to purchase their bonds. "It's prudent. Even if dealing in a private placement, you still want exposure to multiple investors," he said.

Brusewitz said investors tend to be "institutions, registered investment advisors or high net worth individuals buying to hold for the full maturity. They have an investment strategy in place, and are looking for a specific underlying credit rating."

A Word from the MSRB

Back in August 2011 the MSRB issued a notice to financial advisors working with state and local governments, regarding private placements of municipal securities (See MSRB Notice). When financial advisors work with investors – introducing them to issuers or negotiate for them in exchange for compensation, they may be subject to specific federal securities laws.

In the notice, Lynnette Kelly, the MSRB executive director said "private placements as an alternative to traditional public municipal securities offerings" are on the rise and financial advisors should determine whether their activity necessitates registration with the SEC as a broker.

Further, financial advisors who indeed must register with the SEC as brokers would come under the MSRB umbrella of governance over broker-dealers along with Rule G-23, which disallows role switching. When issuers sell bonds through private placements they in essence sidestep the traditional methods of selling municipal securities in the market – through a negotiated or competitive sale. Basically the MSRB is saying that financial advisors to governments might be placement agents and that would trigger some legal requirements, making them subject to specific MSRB broker-dealer rules including reporting underwriting and disclosure of political contributions. The notice also applies to direct "bank loans".

Ten years ago firms could introduce an issuer to investors and in exchange receive transaction based compensation in a private placement. No registration as a broker-dealer was required. Today many different parties are involved, and this has significantly changed the nature of the players – including placement agents, and Dodd-Frank reforms brought in more oversight which the MSRB seems poised to act on. Private placements, as noted above have their place in specific instances but they are not intended to be a cure-all or work-around simply to avoid issuance costs. As their use increases, the MSRB is taking a closer look, possibly ruling by late fall 2012.

Private Placement Vs. Traditional Municipal Bonds

Private Placement Debt Obligations	Traditional Municipal Bonds
Payment flexibility	Payments flexibility
Typically Single Investor	Many Investors
Rapid Funding (~ 30 days)	Funding takes longer (~45-90 days)
Lower Costs of Issuance (placement agent/direct sale)	Higher Costs of Issuance (legal fees, underwriting, registration with SEC)
Shorter Terms 1-15 years	Longer Terms 1-30 years
Secured by Taxes / Collateral	Secured by Taxes / Collateral
Less Disclosure Required	Regular Disclosure Required
Competitive Rates (tax-exempt)	Somewhat Lower rates (tax-exempt)
Deal Size Avg: $100k-$50 million	Deal Size Avg: Any Size

*“**MAC Quarterly**” is a newsletter written for Municipal Advisory Council of Michigan members and business associates. If you have questions you would like discussed in the newsletter, please contact the MAC office. We will answer your questions or find an expert to address the topic and share the information with you in a future issue.*